NEW ISSUES — BOOK-ENTRY ONLY

EXPECTED RATINGS: Moody's: Aaa
S&P: AAA
Fitch: AAA
(see "RATINGS" herein)

In the opinion of Bond Counsel as described herein, (a) interest on the Offered Veterans G.O. Bonds is excluded from gross income for Federal income tax purposes and is exempt from State of California personal income taxes, (b) interest on the Series BY Bonds is not treated as a preference item for purposes of calculating the federal individual and corporate alternative minimum tax; such interest, however, *is included in the adjusted current earnings of certain corporations for purposes of calculating the federal alternative minimum tax imposed on such corporations, and (c) interest on the Series BZ Bonds is treated as a preference item for purposes of calculating the federal individual and corporate alternative minimum tax. See "TAX MATTERS" herein.*

$111,325,000
STATE OF CALIFORNIA
VETERANS GENERAL OBLIGATION BONDS
$3,400,000 Series BY (Non-AMT)
$107,925,000 Series BZ (AMT)

Dated Date: December 1, 2001

This offering consists of veterans general obligation bonds listed above (the "Offered Veterans G.O. Bonds") authorized by the voters of the State of California (the "State").

Interest is payable on June 1 and December 1 of each year, commencing June 1, 2002. The Offered Veterans G.O. Bonds may be purchased in book-entry form only, in the principal amount of $5,000 or any integral multiples thereof. See APPENDIX C—"DTC AND THE BOOK-ENTRY SYSTEM." The Offered Veterans G.O. Bonds are subject to redemption prior to maturity, including redemption at par. See "THE OFFERED VETERANS G.O. BONDS—Redemption."

MATURITIES, PRINCIPAL AMOUNTS, INTEREST RATES, PRICES OR YIELDS, AND CUSIPS

$3,400,000 5% Series BY Serial Bonds due December 1, 2017; Price 100% CUSIP No. 13062NZC4

$88,515,000 5.35% Series BZ Term Bonds due December 1, 2021; Price 100% CUSIP No. 13062NZD2

$19,410,000 5.375% Series BZ Term Bonds due December 1, 2024; Price 100% CUSIP No. 13062NZE0

(plus accrued interest)

The Offered Veterans G.O. Bonds are general obligations of the State to which the full faith and credit of the State are pledged. Principal of, premium, if any, and interest on all State general obligation bonds, including the Offered Veterans G.O. Bonds, are payable from any moneys in the General Fund of the State, subject only to the prior application of such moneys to the support of the public school systems and public institutions of higher education. State law requires funds for the payment of debt service on the Offered Veterans G.O. Bonds to be transferred to the General Fund from the Veterans Farm and Home Building Fund of 1943. See "AUTHORIZATION OF AND SECURITY FOR THE OFFERED VETERANS G.O. BONDS—Security For and Payment of Veterans G.O. Bonds."

MBIA Insurance Corporation ("MBIA") has issued its commitment to insure the payment of the principal of and interest on the Offered Veterans G.O. Bonds on regularly scheduled payment dates. See "OFFERED VETERANS G.O. BONDS MUNICIPAL BOND INSURANCE POLICY."

This cover page contains certain information for quick reference only. It is *not* a summary of this issue. Investors must read the entire Official Statement to obtain information essential to the making of an informed investment decision.

The Offered Veterans G.O. Bonds are offered when, as and if issued and received by the Underwriters set forth below, subject to certain conditions, including the receipt of certain legal opinions of the Honorable Bill Lockyer, Attorney General of the State of California, and of Hawkins, Delafield & Wood, Bond Counsel to the State. In connection with the issuance of the Offered Veterans G.O. Bonds, CSG Advisors Incorporated has served as Pricing Advisor, Quateman & Zidell LLP has served as Disclosure Counsel to the State, and Orrick, Herrington & Sutcliffe LLP has served as Special Counsel to the State regarding APPENDIX A. Certain legal matters will be passed upon for the Underwriters by their counsel, Kutak Rock LLP. The Offered Veterans G.O. Bonds will be available for delivery on or about December 6, 2001.

Honorable Philip Angelides
Treasurer of the State of California

Bear, Stearns & Co. Inc.

Lehman Brothers
First Albany Corporation
Morgan Stanley & Co. Incorporated
Roberts & Ryan Investments Inc.

Great Pacific Securities, Inc.
M.R. Beal & Company
Salomon Smith Barney
Sutro & Co. Incorporated

Merrill Lynch & Co.
Mischler Financial Group, Inc.
Pacific American Securities, LLC
Siebert Brandford Shank & Co., LLC

Dated: November 29, 2001

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Copies of this Official Statement may be obtained from:
HONORABLE PHILIP ANGELIDES
Treasurer of the State of California
P.O. Box 942809
Sacramento, California 94209-0001
(800) 900-3873

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OFFICIAL STATEMENT

$111,325,000
STATE OF CALIFORNIA
VETERANS GENERAL OBLIGATION BONDS
$3,400,000 Series BY (Non-AMT)
$107,925,000 Series BZ (AMT)

INTRODUCTION

This Introduction contains only a brief summary of the terms of the State of California Veterans General Obligation Bonds listed above (the "Offered Veterans G.O. Bonds") and a brief description of the Official Statement; a full review should be made of the entire Official Statement, including the Appendices and information incorporated by reference. All statements contained in this introduction are qualified in their entirety by reference to the entire Official Statement. Summaries of provisions of the Constitution and laws of the State of California or any other documents referred to in this Official Statement do not purport to be complete and such summaries are qualified in their entirety by references to the complete provisions.

Description of the Offered Veterans G.O. Bonds

The issuance of veterans general obligation bonds ("Veterans G.O. Bonds") is authorized by Bond Acts (defined below) approved by the voters of the State of California (the "State") and by resolutions of the Veterans Finance Committee of 1943. The Offered Veterans G.O. Bonds are authorized by specific Bond Acts and are being issued to finance, or to refinance obligations that were issued to provide funds for the financing of, contracts ("Contracts of Purchase") for the purchase of homes and farms for California military veterans under the Farm and Home Purchase Program (the "Program") of the Department of Veterans Affairs of the State (the "Department"). The Offered Veterans G.O. Bonds are being issued for the purposes of refunding certain outstanding Veterans G.O. Bonds and replacing and refunding certain other outstanding Veterans G.O. Bonds on their maturity dates, one consequence of which is that some moneys will become available to finance new Contracts of Purchase between the Department and eligible veterans. See "THE OFFERED VETERANS G.O. BONDS - Purpose" and "- Identification and Authorization of the Offered Veterans G.O. Bonds."

The issuance of the Offered Veterans G.O. Bonds and the anticipated issuance of $117,200,000 Department's Home Purchase Revenue Bonds, 2002 Series A (the "Winter 2002 Revenue Bonds") on March 6, 2002 are expected to result in moneys becoming available for new Contracts of Purchase. The Offered Veterans G.O. Bonds and the Winter 2002 Revenue Bonds are separate bond issues, although they are treated as a single issue for certain Federal tax purposes. The sales and issuances of the Offered Veterans G.O. Bonds and the Winter 2002 Revenue Bonds are separate and independent. The Offered Veterans G.O. Bonds and the Winter 2002 Revenue Bonds will each be offered and sold pursuant to a separate official statement, copies of which, when available, can be obtained from the Department (see "Additional Information").

See EXHIBIT 2 to APPENDIX B - "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA - Veterans G.O. Bonds and Revenue Bonds - Selected Information with Respect to Veterans G.O. Bonds and Revenue Bonds" for information about Veterans G.O. Bonds and Revenue Bonds expected to be refunded and "- Contracts of Purchase - Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments" for information regarding the amount of money expected to be made available to finance Contracts of Purchase upon the issuance of the Offered Veterans G.O. Bonds and the Winter 2002 Revenue Bonds.

The Offered Veterans G.O. Bonds will be registered in the name of a nominee of The Depository Trust Company ("DTC") which will act as securities depository for the Offered Veterans G.O. Bonds. Beneficial interests in the Offered Veterans G.O. Bonds may be purchased in book-entry form only, in denominations of $5,000 or any integral multiple thereof. Principal and interest are payable as specified on the front cover page of this Official Statement. See APPENDIX C – "DTC AND THE BOOK-ENTRY SYSTEM."

Security for and Sources of Payment for Veterans G.O. Bonds

The Offered Veterans G.O. Bonds are general obligations of the State to which the full faith and credit of the State are pledged (see "AUTHORIZATION OF AND SECURITY FOR THE OFFERED VETERANS G.O. BONDS – Security for and Payment of Veterans G.O. Bonds" herein). Principal of and interest on all State general obligations bonds, including the Veterans G.O. Bonds, are payable from moneys in the General Fund of the State Treasury (the "General Fund"), subject only to the prior application of moneys in the General Fund to the support of the public school system and public institutions of higher education. See APPENDIX A – "THE STATE OF CALIFORNIA – State Finances – The General Fund." The Bond Acts authorizing the Offered Veterans G.O. Bonds provide that the State shall collect annually, in the same manner and at the same time as it collects other State revenues, a sum sufficient, in addition to the ordinary revenues of the State, to pay the principal of and interest on the Offered Veterans G.O. Bonds. State law requires funds for the payment of debt service on the Offered Veterans G.O. Bonds to be transferred to the General Fund from the Veterans Farm and Home Building Fund of 1943 (the "1943 Fund"). See "AUTHORIZATION OF AND SECURITY FOR THE OFFERED VETERANS G.O. BONDS – Security for and Payment of Veterans G.O. Bonds" and APPENDIX B – "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND."

Offered Veterans G.O. Bonds Are Insured Under a Municipal Bond Insurance Policy

Concurrently with, and as a condition precedent to, the issuance of the Offered Veterans G.O. Bonds, there will be delivered a financial guaranty insurance policy (the "Offered Veterans G.O. Bonds Municipal Bond Insurance Policy") issued by MBIA Insurance Corporation ("MBIA") guaranteeing the scheduled payment of principal of and interest on the Offered Veterans G.O. Bonds. See "THE OFFERED VETERANS G.O. BONDS MUNICIPAL BOND INSURANCE POLICY" and APPENDIX H – "FORM OF OFFERED VETERANS G.O. BONDS MUNICIPAL BOND INSURANCE POLICY OF MBIA INSURANCE CORPORATION."

Redemption

The Offered Veterans G.O. Bonds are subject to optional and special redemption prior to maturity. In addition, the Series BZ Bonds maturing on December 1, 2021 and December 1, 2024, respectively, are subject to mandatory redemption at par prior to their stated maturities, in part, from sinking fund payments made by the State. See "THE OFFERED VETERANS G.O. BONDS – Redemption."

Information Related to this Official Statement

The information set forth herein has been obtained from official sources which are believed to be reliable, but it is not guaranteed as to accuracy or completeness. The information and expressions of opinion herein are subject to change without notice, and neither delivery of this Official Statement nor any sale made hereunder or any future use of this Official Statement shall, under any circumstances, create any implication that there has been no change in the affairs of the State or the Department since the date hereof.

All financial and other information presented or incorporated by reference in this Official Statement has been provided by, respectively, the State or the Department from its records, *except* for information expressly attributed to other sources. The presentation of information, including tables of receipts from taxes and other revenues, is intended to show recent historic information and is not intended to indicate future or continuing trends in the financial position or other affairs of, respectively, the State or the Department. No representation is made that past experience, as it might be shown by such financial and other information, will necessarily continue or be repeated in the future. Any statements made in this Official Statement involving matters of opinion, projections or estimates, whether expressly stated or not, are set forth as such and not as representations of fact.

A wide variety of other information, including financial information, concerning the State is available from State agencies, State agency publications and State agency websites. Any such information that is inconsistent with the information set forth in this Official Statement should be disregarded. No such information is a part of or incorporated into this Official Statement, except as expressly noted. See "FINANCIAL STATEMENTS" and APPENDIX A–"THE STATE OF CALIFORNIA – FINANCIAL STATEMENTS."

The information in APPENDIX C–"DTC AND THE BOOK-ENTRY SYSTEM" has been furnished by The Depository Trust Company and no representation is made by the State, the Underwriters, the Pricing Advisor or the purchasers of the Offered Veterans G.O. Bonds as to the accuracy or completeness of such information.

Other than with respect to information concerning MBIA contained under the caption "OFFERED VETERANS G.O. BONDS MUNICIPAL BOND INSURANCE POLICY" and APPENDIX H – "FORM OF OFFERED VETERANS G.O. BONDS MUNICIPAL BOND INSURANCE POLICY OF MBIA INSURANCE CORPORATION" herein, none of the information in this Official Statement has been supplied or verified by MBIA and MBIA makes no representation or warranty, express or implied, as to (i) the accuracy or completeness of such information; (ii) the validity of the Offered Veterans G.O. Bonds; or (iii) the tax exempt status of the interest on the Offered Veterans G.O. Bonds.

This Official Statement does not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of the Offered Veterans G.O. Bonds by any person in any jurisdiction in which it is unlawful for such person to make such an offer, solicitation or sale.

No dealer, broker, salesperson or other person has been authorized by the State to give any information or to make any representations other than those contained herein and, if given or made, such other information or representations must not be relied upon as having been authorized by the State. This Official Statement is not to be construed as a contract with the purchasers of the Offered Veterans G.O. Bonds.

IN CONNECTION WITH THE OFFERING OF THE OFFERED VETERANS G.O. BONDS THE UNDERWRITERS MAY OVER ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICES OF THE OFFERED VETERANS G.O. BONDS OFFERED HEREBY AT LEVELS ABOVE THOSE WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

Tax Matters

In the opinion of Hawkins, Delafield & Wood, Bond Counsel to the State ("Bond Counsel"), under existing statutes and court decisions, assuming compliance by the State and the Department with certain tax covenants described therein, (i) interest on the Offered Veterans G.O. Bonds is excluded from gross income for Federal income tax purposes pursuant to Section 103 of the Internal Revenue Code of 1986, as amended (the "Code"), and such interest is exempt from personal income taxes of the State of California under present State law, (ii) interest on the Series BY Bonds is not treated as a preference item for purposes of calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, *however,* is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations, and (iii) interest on the Series BZ Bonds is treated as a preference item for purposes of calculating the alternative minimum tax imposed on individuals and corporations under the Code. See "TAX MATTERS" below, APPENDIX E - "CERTAIN FEDERAL TAX CODE REQUIREMENTS" and APPENDIX G - "LEGAL OPINION OF BOND COUNSEL."

Continuing Disclosure

The Treasurer of the State of California (the "State Treasurer") will agree on behalf of the State to provide annually certain financial information and operating data relating to the State by not later than April 1 of each year in which any Offered Veterans G.O. Bonds are outstanding (the "Treasurer's Annual Report"), commencing with the report for the 2000-2001 Fiscal Year, and to provide notices of the occurrence of certain other enumerated events if material. The Secretary of the Department will agree to provide annually certain financial information and operating data relating to the Program by not later than April 1 of each year in which any Offered Veterans G.O. Bonds are outstanding (the "Department's Annual Report"). The specific nature of the information to be contained in the Treasurer's Annual Report and the Department's Annual Report or the notices of material events and certain other terms of the continuing disclosure obligations are summarized in APPENDIX D - "SUMMARY OF CONTINUING DISCLOSURE CERTIFICATES."

The State and the Department have not failed to comply, in all material respects, with any "previous undertakings," as that term is used in Rule 15c2-12 promulgated under the Securities Exchange Act of 1934, as amended.

Additional Information

Questions regarding this Official Statement and the issuance of these securities may be addressed to the office of the Honorable Philip Angelides, Treasurer of the State of California, P.O. Box 942809, Sacramento, California 94209-0001, telephone (800) 900-3873. Questions regarding the Program should be addressed to the Bond Finance Division of the Department of Veterans Affairs, P.O. Box 942895, Sacramento, California 94295-0001, telephone (916) 653-2081.

AUTHORIZATION OF AND SECURITY FOR THE OFFERED VETERANS G.O. BONDS

Authorization

Each general obligation bond act authorizing the issuance of Veterans G.O. Bonds (each, a "Bond Act") incorporates by reference the State General Obligation Bond Law (the "Law"), which is set forth in Chapter 4 (commencing with Section 16720) of Part 3 of Division 4 of Title 2 of the California Government Code. The Law provides for the authorization, sale, issuance, use of proceeds, repayment and refunding of State general obligation bonds.

Currently, $605,585,000 of new issue Veterans G.O. Bonds are authorized under Bond Acts but not issued. The Offered Veterans G.O. Bonds will not use any of such $605,585,000 authorization. See APPENDIX B – "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND – THE 1943 FUND – General."

Security for and Payment of Veterans G.O. Bonds

The Veterans G.O. Bonds are general obligations of the State, payable in accordance with the Bond Acts out of the General Fund. The full faith and credit of the State are pledged for the punctual payment of the principal of and the interest on the Veterans G.O. Bonds. All payments of principal, premium, if any, and interest on all State general obligation bonds, including the Offered Veterans G.O. Bonds, have an equal claim to the General Fund, subject only to the prior application of moneys in the General Fund to the support of the public school systems and public institutions of higher education. The Bond Acts provide that the State shall collect annually in the same manner and at the same time as it collects other State revenue an amount sufficient, in addition to the ordinary revenue of the State, to pay principal of and interest on the Veterans G.O. Bonds. The Bond Acts also contain a continuing appropriation from the General Fund of the sum annually necessary to pay the principal of and the interest on the Veterans G.O. Bonds as they become due and payable.

The Department's principal fund is the 1943 Fund described in APPENDIX B – "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND – THE 1943 FUND." The Military and Veterans Code of the State (the "Veterans Code"), of which the Bond Acts are a part, requires that on the dates when funds are to be remitted to bondowners for the payment of debt service on Veterans G.O. Bonds in each fiscal year, there shall be transferred to the General Fund to pay the debt service on Veterans G.O. Bonds all of the money in the 1943 Fund (but not in excess of the amount of debt service then due and payable). If the money so transferred on the remittance dates is less than the debt service then due and payable, the balance remaining unpaid is required by the Veterans Code to be transferred to the General Fund out of the 1943 Fund as soon as it shall become available, together with interest thereon from the remittance date until paid, at the same rate of interest as borne by the applicable Veterans G.O. Bonds, compounded semiannually.

The Veterans Code does not grant any lien on the 1943 Fund or the moneys therein to the holders of any Veterans G.O. Bonds. As of August 1, 2001, there were outstanding $2,415,765,000 aggregate principal amount of Veterans G.O. Bonds, not including the Offered Veterans G.O. Bonds. Outstanding Home Purchase Revenue Bonds in the aggregate principal amount of $570,940,000 (as of August 1, 2001, and not including the Winter 2002 Revenue Bonds) previously issued by the Department (collectively with any additional Home Purchase

Revenue Bonds issued by the Department in the future, the "Revenue Bonds") are and will be special obligations of the Department payable solely from, and secured by a pledge of, an undivided interest in the assets of the 1943 Fund (other than proceeds of Veterans G.O. Bonds or any amounts in any rebate account) and any reserve accounts established for the benefit of Revenue Bonds. The Veterans Code provides that this undivided interest in the 1943 Fund is secondary and subordinate to any interest or right in the assets of the 1943 Fund of the people of the State and of the holders of the Veterans G.O. Bonds (that is, the right to payment or reimbursements of debt service on Veterans G.O. Bonds described in the preceding paragraph). If debt service payments to the General Fund are current and all reimbursement of debt service payments with interest as described in the preceding paragraph has been made, no holder or beneficial owner of Veterans G.O. Bonds has any right to restrict disbursements by the Department from the 1943 Fund for any lawful purpose, including payment of debt service on or redemptions and purchases of Revenue Bonds.

For additional information, see APPENDIX B - "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND - THE 1943 FUND" and EXHIBIT 1 to APPENDIX B - "FINANCIAL STATEMENTS OF THE 1943 FUND FOR FISCAL YEARS 2001 AND 2000 AND INDEPENDENT AUDITORS' REPORT."

OFFERED VETERANS G.O. BONDS MUNICIPAL BOND INSURANCE POLICY

General

The Offered Veterans G.O. Bonds are expected to be the subject of an Offered Veterans G.O. Bonds Municipal Bond Insurance Policy described under this heading to be issued by MBIA.

The MBIA Insurance Corporation Insurance Policy

The following information has been furnished by MBIA for use in this Official Statement. Reference is made to APPENDIX H for a specimen of the Offered Veterans G.O. Bonds Municipal Bond Insurance Policy.

The Offered Veterans G.O. Bonds Municipal Bond Insurance Policy unconditionally and irrevocably guarantees the full and complete payment required to be made by or on behalf of the State Treasurer of an amount equal to (i) the principal of (either at the stated maturity or by an advancement of maturity pursuant to a mandatory sinking fund payment) and interest on, the Offered Veterans G.O. Bonds as such payments shall become due but shall not be so paid (except that in the event of any acceleration of the due date of such principal by reason of mandatory or optional redemption or acceleration resulting from default or otherwise, other than any advancement of maturity pursuant to a mandatory sinking fund payment, the payments guaranteed by the Offered Veterans G.O. Bonds Municipal Bond Insurance Policy shall be made in such amounts and at such times as such payments of principal would have been due had there not been any such acceleration); and (ii) the reimbursement of any such payment which is subsequently recovered from any owner of the Offered Veterans G.O. Bonds pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such owner within the meaning of any applicable bankruptcy law (a "Preference").

The Offered Veterans G.O. Bonds Municipal Bond Insurance Policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any Offered Veterans G.O. Bonds. The Offered Veterans G.O. Bonds Municipal Bond Insurance Policy does not, under any circumstance, insure against loss relating to: (i) optional or mandatory redemptions (other than mandatory sinking fund redemptions); (ii) any payments to be made on an accelerated basis; (iii) payments of the purchase price of Offered Veterans G.O. Bonds upon tender by an owner thereof; or (iv) any Preference relating to (i) through (iii) above. The Offered Veterans G.O. Bonds Municipal Bond Insurance Policy also does not insure against nonpayment of principal of or interest on the Offered Veterans G.O. Bonds resulting from the insolvency, negligence or any other act or omission of the State Treasurer or any other paying agent for the Offered Veterans G.O. Bonds.

Upon receipt of telephonic or telegraphic notice, such notice subsequently confirmed in writing by registered or certified mail, or upon receipt of written notice by registered or certified mail, by MBIA from the paying agent or any owner of an Offered Veterans G.O. Bond the payment of an insured amount for which is then due, that such required payment has not been made, MBIA on the due date of such payment or within one business day after receipt of notice of such nonpayment, whichever is later, will make a deposit of funds, in an account with State Street Bank and Trust Company, N.A., in New York, New York, or its successor, sufficient for the payment of any such insured amounts which are then due. Upon presentment and surrender of such Offered Veterans G.O. Bond or presentment of such other proof of ownership of the Offered Veterans G.O. Bond, together with any appropriate instruments of assignment to evidence the assignment of the insured amounts due on the Offered Veterans G.O. Bonds as are paid by MBIA, and appropriate instruments to effect the appointment of MBIA as agent for such owners of the Offered Veterans G.O. Bonds in any legal proceeding related to payment of insured amounts on the Offered Veterans G.O. Bonds, such instruments being in a form satisfactory to State Street Bank and Trust Company, N.A., State Street Bank and Trust Company, N.A. shall disburse to such owners or the paying agent payment of the insured amounts due on such Offered Veterans G.O. Bonds, less any amount held by the paying agent for the payment of such insured amounts and legally available therefor.

MBIA

MBIA is the principal operating subsidiary of MBIA Inc., a New York Stock Exchange listed company (the "Company"). The Company is not obligated to pay the debts of or claims against MBIA. MBIA is domiciled in the State of New York and licensed to do business in and subject to regulation under the laws of all 50 states, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, the Virgin Islands of the United States and the Territory of Guam. MBIA has three branches, one in the Republic of France, one in the Republic of Singapore and one in the Kingdom of Spain. New York has laws prescribing minimum capital requirements, limiting classes and concentrations of investments and requiring the approval of policy rates and forms. State laws also regulate the amount of both the aggregate and individual risks that may be insured, the payment of dividends by MBIA, changes in control and transactions among affiliates. Additionally, MBIA is required to maintain contingency reserves on its liabilities in certain amounts and for certain periods of time.

MBIA does not accept any responsibility for the accuracy or completeness of this Official Statement or any information or disclosure contained herein, or omitted herefrom, other than with respect to the accuracy of the information regarding the Offered Veterans G.O. Bonds Municipal

Bond Insurance Policy and MBIA set forth under the heading "THE OFFERED VETERANS G.O. BONDS MUNICIPAL BOND INSURANCE POLICY". Additionally, MBIA makes no representation regarding the Offered Veterans G.O. Bonds or the advisability of investing in the Offered Veterans G.O. Bonds.

The Offered Veterans G.O. Bonds Municipal Bond Insurance Policy is not covered by the Property/Casualty Insurance Security Fund specified in Article 76 of the New York Insurance Law.

MBIA Information

The following documents filed by the Company with the Securities and Exchange Commission (the "SEC") are incorporated herein by reference:

(1) The Company's Annual Report on Form 10-K for the year ended December 31, 2000;

(2) The Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2001; and

(3) The report on Form 8-K filed by the Company on January 30, 2001.

Any documents filed by the Company pursuant to Sections 13(a), 13(c), 14 or 15(d) of the Exchange Act of 1934, as amended, after the date of this Official Statement and prior to the termination of the offering of the Offered Veterans G.O. Bonds offered hereby shall be deemed to be incorporated by reference in this Official Statement and to be a part hereof. Any statement contained in a document incorporated or deemed to be incorporated by reference herein, or contained in this Official Statement, shall be deemed to be modified or superseded for purposes of this Official Statement to the extent that a statement contained herein or in any other subsequently filed document which also is or is deemed to be incorporated by reference herein modifies or supersedes such statement. Any such statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Official Statement.

The Company files annual, quarterly and special reports, information statements and other information with the SEC under File No. 1-9583. Copies of the SEC filings (including (1) the Company's Annual Report on Form 10-K for the year ended December 31, 2000, (2) the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2001, and (3) the report on Form 8-K filed by the Company on January 30, 2001) are available (i) over the Internet at the SEC's web site at http://www.sec.gov; (ii) at the SEC's public reference room in Washington D.C.; (iii) over the Internet at the Company's web site at http://www.mbia.com; and (iv) at no cost, upon request to MBIA Insurance Corporation, 113 King Street, Armonk, New York 10504. The telephone number of MBIA is (914) 273-4545.

As of December 31, 2000, MBIA had admitted assets of $7.6 billion (audited), total liabilities of $5.2 billion (audited), and total capital and surplus of $2.4 billion (audited) determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities. As of September 30, 2001, MBIA had admitted assets of $8.4 billion (unaudited), total liabilities of $6.0 billion (unaudited), and total capital and surplus of $2.4 billion (unaudited) determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities.

Financial Strength Ratings of MBIA

Moody's Investors Service, Inc. ("Moody's") rates the financial strength of MBIA "Aaa."

Standard & Poor's, a division of The McGraw-Hill Companies, Inc. ("S&P") rates the financial strength of MBIA "AAA."

Fitch, Inc. ("Fitch") rates the financial strength of MBIA "AAA."

Each rating of MBIA should be evaluated independently. The ratings reflect the respective rating agency's current assessment of the creditworthiness of MBIA and its ability to pay claims on its policies of insurance. Any further explanation as to the significance of the above ratings may be obtained only from the applicable rating agency.

The above ratings are not recommendations to buy, sell or hold the Offered Veterans G.O. Bonds, and such ratings may be subject to revision or withdrawal at any time by the rating agencies. Any downward revision or withdrawal of any of the above ratings may have an adverse effect on the market price of the Offered Veterans G.O. Bonds. MBIA does not guaranty the market price of the Offered Veterans G.O. Bonds nor does it guaranty that the ratings on the Offered Veterans G.O. Bonds will not be revised or withdrawn.

In the event MBIA were to become insolvent, any claims arising under a policy of financial guaranty insurance are excluded from coverage by the California Insurance Guaranty Association, established pursuant to Article 14.2 (commencing with Section 1063) of Chapter 1 of Part 2 of Division 1 of the California Insurance Code.

THE OFFERED VETERANS G.O. BONDS

General

The Offered Veterans G.O. Bonds will be registered in the name of the nominee of DTC, which will act as securities depository for the Offered Veterans G.O. Bonds. Beneficial interests in the Offered Veterans G.O. Bonds may be purchased in book-entry form only, in denominations of $5,000 or any integral multiple thereof. See APPENDIX C – "DTC AND THE BOOK-ENTRY SYSTEM."

The Offered Veterans G.O. Bonds will be dated the Dated Date (as shown on the cover page hereof) and will mature on the respective dates and in the respective amounts set forth on the cover page hereof. Interest on the Offered Veterans G.O. Bonds will accrue from the Dated Date at the respective rates shown on the cover page of this Official Statement. Interest on the Offered Veterans G.O. Bonds is payable on June 1 and December 1 in each year (each, an "Interest Payment Date") commencing June 1, 2002 and shall be calculated on the basis of a 360-day year comprised of twelve 30-day months.

Principal and interest are payable directly to DTC by the State Treasurer. Upon receipt of payments of principal and interest, DTC is to in turn remit such principal and interest to the participants in DTC for disbursement to the beneficial owners of the Offered Veterans G.O. Bonds. The record date for the payment of interest on the Offered Veterans G.O. Bonds is the close of business on the 15th day of the month immediately preceding an Interest Payment Date, whether or not the record date falls on a business day.

In reading this Official Statement it should be understood that while the Offered Veterans G.O. Bonds are in the Book-Entry-Only System, (i) all rights of ownership must be exercised through DTC and the Book-Entry-Only System, and (ii) notices that are to be given to registered owners by the State will be given only to DTC.

Purpose

Under the Program, the Department acquires residential property to be sold to eligible veterans under Contracts of Purchase between the Department and such veterans. Such acquisition is financed principally with the proceeds of Veterans G.O. Bonds and the Department's Revenue Bonds. The Offered Veterans G.O. Bonds are being issued for the purposes of refunding certain outstanding Veterans G.O. Bonds and replacing and refunding certain other outstanding Veterans G.O. Bonds on their maturity dates, one consequence of which is that some moneys will become available to finance new Contracts of Purchase between the Department and eligible veterans. See EXHIBIT 2 to APPENDIX B - "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA - Veterans G.O. Bonds and Revenue Bonds - Selected Information with Respect to Veterans G.O. Bonds and Revenue Bonds" for information about Veterans G.O. Bonds expected to be refunded and "- Contracts of Purchase - Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments" for information regarding the amount of money expected to be made available to finance Contracts of Purchase upon the issuance of the Offered Veterans G.O. Bonds.

The Department expects to issue the $117,200,000 Winter 2002 Revenue Bonds on March 6, 2002. The Winter 2002 Revenue Bonds are being issued to refund certain optionally redeemable Revenue Bonds with bonds of significantly later maturity, thereby making funds available to finance Contracts of Purchase.

See EXHIBIT 2 to APPENDIX B - "DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND - Certain Department Financial Information and Operating Data - Contracts of Purchase - Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments."

Identification and Authorization of the Offered Veterans G.O. Bonds

The Series BY Bonds are issued under one Bond Act and the Series BZ Bonds are issued under three Bond Acts, authorized by the voters, as described below. See APPENDIX A - "THE STATE OF CALIFORNIA - State Indebtedness."

Authorization

$3,400,000 principal amount of Veterans General Obligation Bonds, Series BY, authorized under the Veterans Bond Act of 1988.

$23,690,000 principal amount of Veterans General Obligation Bonds, Series BZ1, authorized under the Veterans Bond Act of 1986.

$42,425,000 principal amount of Veterans General Obligation Bonds, Series BZ2, authorized under the Veterans Bond Act of 1988.

$41,810,000 principal amount of Veterans General Obligation Bonds, Series BZ3, authorized under the Veterans Bond Act of 1990.

Redemption

Sinking Fund Redemption

The Series BZ Bonds maturing on December 1, 2021 and December 1, 2024, respectively (the "Term Bonds"), are subject to redemption prior to their respective stated maturity dates, in part, by lot, from sinking fund payments, at a redemption price of 100 percent of the principal amount thereof, plus accrued interest to the date fixed for redemption, without premium, on the respective dates and in the respective amounts shown below.

SINKING FUND REDEMPTION SCHEDULE

December 1	Series BZ Bonds Maturing December 1, 2021	Series BZ Bonds Maturing December 1, 2024
2018	$20,025,000	
2019	21,365,000	
2020	22,800,000	
2021	24,325,000†	
2022		$5,745,000
2023		6,130,000
2024		7,535,000†

† Stated Maturity.

If less than all of the Term Bonds of the same maturity date are purchased or called for redemption (other than in satisfaction of sinking fund payments), the State Treasurer will credit the principal amount of such Term Bonds that are so purchased or redeemed against applicable remaining sinking fund payments relating to such Term Bonds (including the principal amounts due on the respective maturity dates, as shown above), as requested by the Department.

Optional Redemption

The Offered Veterans G.O. Bonds are subject to optional redemption prior to their respective stated maturity dates, at the option of the State upon request of the Department, in whole or in part (of any maturity and by lot within each maturity), on any date on or after June 1, 2007 at the redemption prices stated below, plus accrued interest to the date fixed for redemption:

Redemption Dates (both dates inclusive)	Redemption Price (as percentage of principal amount redeemed)
June 1, 2007 to May 31, 2008	101%
June 1, 2008 and thereafter	100%

Special Redemption from Unexpended Proceeds

The Offered Veterans G.O. Bonds are subject to special redemption on any date prior to their respective stated maturity dates, at the option of the State upon request of the Department, from moneys deposited in the GO Bond Series Proceeds Subaccount with respect to the Offered Veterans G.O. Bonds that have not been applied to finance Contracts of Purchase. Any such redemption may be in part (and of any maturity of any Series at the option of the State upon request of the Department and by lot within such maturity), at the principal amount thereof plus accrued interest to the date fixed for redemption, without premium. See EXHIBIT 2 to APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments" for a discussion of the amount of moneys expected to be deposited in the GO Bond Series Proceeds Subaccount with respect to the Offered G.O. Bonds upon the issuance of the Offered Veterans G.O. Bonds.

Factors which may affect the demand for Contracts of Purchase and consequently the Department's ability to use all of the proceeds of the Offered Veterans G.O. Bonds and Excess Revenues for the financing of Contracts of Purchase include not only general economic conditions, but also (among other factors) the relationship between alternative mortgage loan interest rates (including rates on mortgage loans insured or guaranteed by agencies of the federal government, rates on conventional mortgage loans, and the rates on other Contracts of Purchase available from the Department), the interest rates being charged on the Contracts of Purchase by the Department, the general level of home purchase and construction activity in the State, and the demographics of the eligible veterans population. These factors could cause a lack of demand for Contracts of Purchase financed by the Offered Veterans G.O. Bonds and could necessitate the exercise by the Department of its right to apply the unused proceeds and Excess Revenues to redeem the Offered Veterans G.O. Bonds. See EXHIBIT 2 to APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – New Contracts of Purchase During the Fiscal Year" for information regarding the recent rate of originations of Contracts of Purchase, and "– Selected Principal Flows with respect to Contracts of Purchase Funded by both Veterans G.O. Bonds and Revenue Bonds" for the interest rates on new Contracts of Purchase originated since January 1, 1999.

Moneys are currently available through the issuance of Veterans G.O. Bonds and Revenue Bonds to finance Contracts of Purchase, and additional moneys may become available to finance Contracts of Purchase through the concurrent and future issuances of Revenue Bonds and Veterans G.O. Bonds. Since the Department has full discretion, subject to eligibility requirements and the requirements of the Internal Revenue Code of 1954, as amended, or the Code, as applicable (collectively, the "Federal Tax Code"), in applying the proceeds of all of these bonds to finance the Program, the proceeds of prior and future Veterans G.O. Bonds and Revenue Bonds, including the Winter 2002 Revenue Bonds, may be used to finance Contracts of Purchase before proceeds of the Offered Veterans G.O. Bonds. See APPENDIX B – "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND – THE PROGRAM – Qualifying Veteran Status" for information regarding eligibility requirements for different moneys made available by the Department and EXHIBIT 2 to APPENDIX B – "CERTAIN

DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments" for information regarding the amount of money expected to become available to finance Contracts of Purchase upon the issuance of the Offered Veterans G.O. Bonds and the Winter 2002 Revenue Bonds.

Special Redemption from Excess Revenues

The Offered Veterans G.O. Bonds are subject to special redemption on any date prior to their respective stated maturity dates, at the option of the State upon request of the Department, from Excess Revenues (as defined below) derived from any Veterans G.O. Bonds or any Revenue Bonds. Any such redemption may be in whole or in part (and of any maturity of any Series at the option of the State upon request of the Department and by lot within such maturity), at the principal amount thereof plus accrued interest to the date fixed for redemption, without premium.

"Excess Revenues" means, as of any date of calculation, Revenues in excess of Accrued Debt Service. Excess Revenues can include prepayments and repayments on Contracts of Purchase funded by Revenue Bonds and Veterans G.O. Bonds, investment earnings, certain insurance receipts and also includes Revenues which had been set aside to be recycled into new Contracts of Purchase. All payments on Contracts of Purchase are deposited in the 1943 Fund and applied to pay or reimburse debt service on the Veterans G.O. Bonds, to pay debt service on Revenue Bonds, to pay for mandatory redemptions of Veterans G.O. Bonds and Revenue Bonds, to pay Program and Department expenses, and to pay certain insurance claims. The Department, subject to applicable bond authorizing resolutions, may apply Excess Revenues to redeem any Veterans G.O. Bonds or Revenue Bonds eligible for redemption. The Department's decision to apply Excess Revenues to redeem bonds, to finance new Contracts of Purchase, or for any other permitted purpose depends on many factors, including but not limited to applicable bond authorizing resolution requirements, demand for Contracts of Purchase, debt service cost savings, investment earnings, and Federal Tax Code requirements. See APPENDIX B – "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND – THE 1943 FUND – Excess Revenues."

Certain of the outstanding Veterans G.O. Bonds are not subject to redemption prior to maturity. However, the Offered Veterans G.O. Bonds are subject to such redemption. See EXHIBIT 2 to APPENDIX B – "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND – CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA."

The Department's actual past prepayment experience for existing Contracts of Purchase is set forth in EXHIBIT 2 to APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Contracts of Purchase Origination and Principal Repayment Experience." However, since the Department substantially reduced the interest rates on most existing Contracts of Purchase in January 1999, the prepayment experience reflected in the chart may not predict the future behavior of such Contracts of Purchase after the interest rate reduction.

For certain Revenue Bonds issued or to be issued after 1988, the Federal Tax Code prohibits repayments (including prepayments) of principal of Contracts of Purchase financed with the proceeds of an issue of such bonds to be used to make additional Contracts of Purchase after 10 years from the date of issuance of such bonds (or the date of issuance of original bonds in the case of refundings), after which date such amounts must be used to redeem such bonds of the issue, except for a $250,000 *de minimis* amount. See "TAX MATTERS – Federal Tax Matters – Proposed Federal Tax Legislation."

The Federal Tax Code requires a payment to the United States from certain veterans whose Contracts of Purchase are originated after December 31, 1990 with the proceeds of certain Revenue Bonds. Since such requirement remains in effect with respect to any Contracts of Purchase originated after December 31, 1990 with proceeds of the applicable Revenue Bonds, for a period ending nine years after the execution of such Contracts of Purchase, the Department is unable to predict what effect, if any, such requirement will have on the origination or prepayment of Contracts of Purchase to which such provision applies.

Notice of Redemption

When redemption is required while the Offered Veterans G.O. Bonds are in book-entry form, the State Treasurer is to give notice of redemption by mailing copies of such notice only to DTC (not to the beneficial owners of the Offered Veterans G.O. Bonds) not less than thirty or more than sixty days prior to the date fixed for redemption. DTC, in turn, is to send the notice of redemption to its participants for distribution to the beneficial owners of the Offered Veterans G.O. Bonds. See APPENDIX C – "BOOK-ENTRY SYSTEM." The notice will state, among other things, that the Offered Veterans G.O. Bonds or a designated portion thereof (in the case of partial redemption of an Offered Veterans G.O. Bond) are to be redeemed, the dated date of the Offered Veterans G.O. Bonds, the redemption date, the Series and maturities of the Offered Veterans G.O. Bonds to be redeemed and the redemption price. The notice will also state that after the date fixed for redemption, no further interest will accrue on the principal of any Offered Veterans G.O. Bonds called for redemption. Notice of redemption will also be provided by mail to certain financial information services and securities depositories.

TAX MATTERS

Federal Tax Matters

The Offered Veterans G.O. Bonds are considered a single issue for Federal income tax purposes with the Winter 2002 Revenue Bonds. The requirements of applicable Federal tax law must be satisfied with respect to each series of the Offered Veterans G.O. Bonds and the Winter 2002 Revenue Bonds in order that interest on the Offered Veterans G.O. Bonds not be included in gross income for Federal income tax purposes retroactive to the date of issuance thereof. Proceeds of the Offered Veterans G.O. Bonds and the Winter 2002 Revenue Bonds must be used to retire outstanding bonds within ninety days of their respective dates of issuance. Failure to so use all of such proceeds and to comply with other requirements of the Federal Tax Code with respect to either the Offered Veterans G.O. Bonds or the Winter 2002 Revenue Bonds could cause interest on the Offered Veterans G.O. Bonds to be included in gross income for Federal income tax purposes retroactive to their date of issuance.

Requirements Imposed on the Offered Veterans G.O. Bonds and the Winter 2002 Revenue Bonds by the Federal Tax Code

The Federal Tax Code contains the following loan eligibility requirements which are applicable (with certain exceptions), in whole or in part, to Contracts of Purchase (or portions of Contracts of Purchase) entered into with respect to properties acquired with amounts allocable to qualified veterans' mortgage bonds and/or to qualified mortgage bonds. The Offered Veterans G.O. Bonds are qualified veterans' mortgage bonds and not qualified mortgage bonds, and the Winter 2002 Revenue Bonds are pre-Ullman bonds (as such terms are defined in APPENDIX E). The Winter 2002 Revenue Bonds are treated for Federal income tax purposes as refunding certain existing pre-Ullman bonds issued to finance the Program. The moneys which will be made available from the issuance of the Offered Veterans G.O. Bonds to finance Contracts of Purchase will be Qualified Veterans Mortgage Bond Proceeds, while the moneys which will be made available from the issuance of the Winter 2002 Revenue Bonds to finance Contracts of Purchase will be Unrestricted Moneys (as such terms are defined in APPENDIX B). The loan eligibility requirements described in APPENDIX E - "CERTAIN FEDERAL TAX CODE REQUIREMENTS" do not apply to Unrestricted Moneys. These requirements also do not apply to the Contracts of Purchase to be allocated to the Winter 2002 Revenue Bonds for Federal income tax purposes following payment of the bonds being refunded by the Winter 2002 Revenue Bonds, including any new Contracts of Purchase so allocated. The Federal Tax Code establishes other requirements described below which will apply to the Winter 2002 Revenue Bonds.

The first general requirement of the Federal Tax Code which is applicable to qualified veterans' mortgage bonds is that the aggregate amount that may be issued must not exceed the volume limit based upon statutory formula. The Offered Veterans G.O. Bonds are in compliance with such requirement.

The Federal Tax Code requires that the effective interest rate on mortgage loans financed with the lendable proceeds of qualified mortgage bonds and qualified veterans' mortgage bonds (such as the Offered Veterans G.O. Bonds) may not exceed the yield on the issue by more than 1.125% (1.50% for pre-Ullman bonds such as the Winter 2002 Revenue Bonds) (see "Yield Limitations and Rebate" in APPENDIX E) and that certain investment earnings on non-mortgage investments, calculated based upon the extent such investment earnings exceed the amount that would have been earned on such investments if the investments were invested at a yield equal to the yield on the issue, be rebated to the United States or to veterans. The Department has covenanted to comply with these requirements and has established procedures to determine the amount of excess earnings, if any, that must be rebated to the United States or to veterans. See APPENDIX B - "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND - THE PROGRAM - Contracts of Purchase" for discussions of provisions of the Veterans Code which affect the Department's ability to establish and to change interest rates on Contracts of Purchase.

The Federal Tax Code states that an issuer will be treated as meeting the arbitrage restrictions on mortgage loans if it in good faith attempted to meet such requirement and any failure to meet such requirement was due to inadvertent error after taking all reasonable steps to comply with such requirement. See APPENDIX E - "CERTAIN FEDERAL TAX CODE REQUIREMENTS."

Opinion of Bond Counsel

In the opinion of Bond Counsel (expected to be delivered in substantially the form set forth with respect to the Offered Veterans G.O. Bonds in APPENDIX G), under existing statutes and court decisions and assuming continuing compliance with certain tax covenants described herein, (i) interest on the Offered Veterans G.O. Bonds is excluded from gross income for Federal income tax purposes pursuant to Section 103 of the Code, (ii) interest on the Series BY Bonds is not treated as a preference item for purposes of calculating the alternative minimum tax imposed on individuals and corporations under the Federal Tax Code; such interest, *however,* is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations, and (iii) interest on the Series BZ Bonds is treated as a preference item for purposes of calculating the alternative minimum tax imposed on individuals and corporations under the Federal Tax Code.

In rendering the foregoing opinions, Bond Counsel has assumed and continues to assume compliance by the State and the Department with and enforcement by the State and the Department of the documents authorizing the issuance of the Offered Veterans G.O. Bonds and the Winter 2002 Revenue Bonds and the applicable Program Documents (as such term is defined in APPENDIX E). Bond Counsel has expressed and expresses no opinion as to the exclusion from gross income of interest on any Offered Veterans G.O. Bonds subsequent to any date on which action is taken pursuant to the documents authorizing the issuance of the Offered Veterans G.O. Bonds, for which action such documents require a legal opinion to the effect that taking such action will not adversely affect such exclusion, unless such firm delivers an opinion as of such date to such effect.

In rendering its opinions, Bond Counsel expresses no opinion regarding any other Federal or, except as stated below under "State Tax Matters," state tax consequences with respect to the Offered Veterans G.O. Bonds. Bond Counsel renders its opinions under existing statutes and court decisions as of the issue date, and assumes no obligation to update its opinions after the issue date to reflect any future action, fact or circumstance, or change in law or interpretation, or otherwise. In rendering its opinions, Bond Counsel expresses no opinion on the effect of any action taken after the date of the opinion or not taken in reliance upon an opinion of other counsel on the exclusion from gross income for Federal income tax purposes of interest on the Offered Veterans G.O. Bonds, or under state and local tax law.

Certain Collateral Federal Tax Consequences

The following is a brief discussion of certain Federal income tax matters with respect to the Offered Veterans G.O. Bonds under existing statutes. It does not purport to deal with all aspects of Federal taxation that may be relevant to a particular owner of an Offered Veterans G.O. Bond. Prospective investors, particularly those who may be subject to special rules, are advised to consult their own tax advisors regarding the Federal tax consequences of owning and disposing of the Offered Veterans G.O. Bonds.

As noted above, interest on the Series BZ Bonds is, and interest on the Series BY Bonds is not, a preference item in determining the tax liability of individuals, corporations, and other taxpayers subject to the alternative minimum tax imposed by Section 55 of the Federal Tax Code. Interest on the Offered Veterans G.O. Bonds must also be taken into account in determining the tax liability of foreign corporations subject to the branch profits tax imposed by Section 884 of the Federal Tax Code.

Prospective Owners of Offered Veterans G.O. Bonds should be aware that the ownership of such obligations may result in collateral Federal income tax consequences to various categories of persons, such as corporations (including S corporations and certain foreign corporations), financial institutions, property and casualty insurance companies, individual recipients of Social Security or Railroad Retirement benefits, and individuals otherwise eligible for the earned income tax credit and to taxpayers deemed to have incurred or continued indebtedness to purchase or carry obligations the interest on which is not included in gross income for Federal income tax purposes.

Legislation affecting municipal bonds is frequently considered by the United States Congress. There can be no assurance that legislation enacted or proposed after the date of issuance of the Offered Veterans G.O. Bonds will not have an adverse effect on the tax-exempt status or market price of the Offered Veterans G.O. Bonds.

State Tax Matters

In the opinion of Bond Counsel to be rendered with respect to the Offered Veterans G.O. Bonds on the date of delivery thereof, interest on the Offered Veterans G.O. Bonds is exempt from personal income taxes of the State of California under State law in effect on the date of such opinion. A complete copy of the proposed form of opinion to be rendered with respect to the Offered Veterans G.O. Bonds is contained in APPENDIX G.

LEGAL OPINIONS

The opinion of the Honorable Bill Lockyer, Attorney General of the State of California (the "Attorney General"), approving the validity of the Offered Veterans G.O. Bonds, will accompany the Offered Veterans G.O. Bonds deposited with DTC. The opinion of Bond Counsel approving the validity of the Offered Veterans G.O. Bonds and addressing certain tax matters will also accompany the Offered Veterans G.O. Bonds deposited with DTC. The proposed forms of the legal opinions of the Attorney General and Bond Counsel are set forth in APPENDIX F and APPENDIX G, respectively.

Certain legal matters will be passed upon by Quateman & Zidell LLP, Disclosure Counsel to the State, and by Orrick, Herrington & Sutcliffe LLP, Special Counsel to the State regarding APPENDIX A. Certain legal matters will be passed upon for the Underwriters by their counsel, Kutak Rock LLP.

The Attorney General, Bond Counsel, Disclosure Counsel, Special Counsel and counsel to the Underwriters undertake no responsibility for the accuracy, completeness or fairness of this Official Statement.

LITIGATION

The Attorney General has advised that, to the best of his knowledge, no litigation is now pending (with service of process on the State or the Department having been accomplished) or threatened seeking to restrain or enjoin the sale, issuance, execution or delivery of the Offered Veterans G.O. Bonds or challenging the validity of the Offered Veterans G.O. Bonds or any proceedings or authority under which the Offered Veterans G.O. Bonds are being issued, except as follows.

As stated above, payment of the debt service on general obligation bonds of the State is contained as a continuing appropriation in the Bond Acts approved by the voters. In June 1998, a complaint was filed in Los Angeles County Superior Court in the case of *Howard Jarvis Taxpayers Association et al. v. Connell* challenging the authority of the State Controller to make payments in the absence of a State budget. The lawsuit did not specifically attack the validity of the Bond Acts or the continuing appropriations of funds to pay principal and interest on general obligation bonds. The Superior Court judge, however, issued a preliminary injunction preventing the State Controller from making payments, including those made pursuant to continuing appropriations, prior to the enactment of the State's annual budget. As permitted by the State Constitution, the Legislature immediately enacted and the Governor signed an emergency appropriations bill that allowed continued payment of various State obligations, including debt service. See APPENDIX A - "THE STATE OF CALIFORNIA - LITIGATION" for more information about the status of this case.

The Attorney General and Bond Counsel will render an opinion that the conclusion of the Superior Court judge in the *Jarvis* case (which is now stayed pending appeal) questioning the validity of continuing appropriations, if and to the extent it would apply to the payment of debt service on the Offered Veterans G.O. Bonds, is without merit and that the California appellate courts would hold that the appropriations for debt service on the Offered Veterans G.O. Bonds contained in the Bond Acts are valid under the State Constitution and that the State Controller may make payments pursuant to such appropriations. While there can be no assurance as to the outcome of litigation, the State believes moneys will be available in due course on a timely basis to make all future payments of debt service on the Offered Veterans G.O. Bonds.

While at any given time, including the present, there are numerous civil actions pending against the State (including, but not limited to, those discussed in APPENDIX A), that could, if determined adversely to the State, affect the State's expenditures and, in some cases, its revenues, the Attorney General is of the opinion that no pending actions (with service of process on the State having been accomplished) are likely to have a material adverse effect on the State's ability to pay principal of, premium, if any, and interest on the Offered Veterans G.O. Bonds when due. See APPENDIX A - "THE STATE OF CALIFORNIA - LITIGATION."

There may, from time to time, be litigation affecting the Department that does not directly relate to the Veterans G.O. Bonds, which may nonetheless relate to the 1943 Fund. See APPENDIX B - "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND - THE 1943 FUND - Debbs Litigation" for a discussion of certain litigation relating to the Department and the 1943 Fund.

UNDERWRITING

The Offered Veterans G.O. Bonds are being purchased by the Underwriters listed on the cover page. The Underwriters have jointly and severally agreed to purchase the Offered Veterans G.O. Bonds for a purchase price of the aggregate principal amount thereof plus accrued interest. In connection therewith the Department will pay a fee to the Underwriters of $897,741.53. The initial public offering prices of the Offered Veterans G.O. Bonds may be changed from time to time by the Underwriters.

The purchase contract relating to the Offered Veterans G.O. Bonds provides that (i) the Underwriters will purchase all of the Offered Veterans G.O. Bonds if any of the Offered Veterans G.O. Bonds are purchased, and (ii) the obligation to make such purchase is subject to certain terms and conditions set forth in such purchase contract including, among others, the approval of certain legal matters by counsel.

FINANCIAL STATEMENTS

Audited General Purpose Financial Statements of the State of California (the "Financial Statements") are available for the Fiscal Year ended June 30, 2000. Such Financial Statements have been filed with all of the Nationally Recognized Municipal Securities Information Repositories, as part of an Official Statement for certain State General Obligation Bonds sold previously this year, and are incorporated by reference into this Official Statement. The Financial Statements are also available through electronic means. No such information is a part of or incorporated into this Official Statement, except as expressly noted. See APPENDIX A – "THE STATE OF CALIFORNIA – FINANCIAL STATEMENTS" for further information on how to obtain or view the Financial Statements.

Certain unaudited financial information for the Fiscal Year ended June 30, 2001 is included as EXHIBIT 1 to APPENDIX A. See APPENDIX A – EXHIBIT 1 – STATE CONTROLLER'S "STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS, July 1, 2000 - June 30, 2001 (Unaudited)" and EXHIBIT 2 – STATE CONTROLLER'S "STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS, July 1, 2001 - September 30, 2001 (Unaudited)."

INDEPENDENT AUDITORS

Attached as EXHIBIT 1 to APPENDIX B are the Financial Statements for the Veterans Farm and Home Building Fund of 1943 for the years ended June 30, 2001 and 2000. These statements have been audited by Deloitte & Touche LLP, independent auditors, as indicated in their report appearing in APPENDIX B.

RATINGS

The Underwriters' obligation to purchase the Offered Veterans G.O. Bonds are conditioned upon the Offered Veterans G.O. Bonds receiving ratings of "Aaa" by Moody's, "AAA" by S&P, and "AAA" by Fitch. Such ratings will be based on the issuance of the Offered Veterans G.O. Bonds Municipal Bond Insurance Policy. An explanation of the significance and status of such credit ratings may be obtained from the rating agencies furnishing the same. There is no assurance that such ratings will continue for any given period of time or that they will not be revised or withdrawn entirely by any such rating agencies if, in their respective judgments, circumstances so warrant. On April 24, 2001, S&P lowered the State's general obligation bond rating from "AA" to "A+" and S&P's rating outlook remains negative. However, the S&P rating on the Offered Veterans G.O. Bonds and all outstanding Veterans G.O. Bonds is "AA-," and S&P's rating outlook on such bonds is stable. On November 20, 2001, Moody's lowered the State's general obligation bond rating from "Aa3" to "A1," which followed a downgrade on May 15, 2001 from "Aa2 to Aa3," and the Moody's outlook remains negative. On April 18, 2001, Fitch placed the State's "AA" rating on rating watch - negative. Further revisions or withdrawal of a credit rating could have an effect on the market price of the Offered Veterans G.O. Bonds. After the Offered Veterans G.O. Bonds are rated, the State Treasurer intends to provide appropriate periodic credit information to the rating agencies.

ADDITIONAL INFORMATION

The purpose of this Official Statement is to supply information to prospective buyers of the Offered Veterans G.O. Bonds. CSG Advisors Incorporated served as the Pricing Advisor to the State in connection with the issuance of the Offered Veterans G.O. Bonds.

The State Treasurer will execute a certificate upon delivery of the Offered Veterans G.O. Bonds to the effect that, to the best of the State Treasurer's knowledge and belief, as of the delivery date, the information and statements, including financial statements, of or pertaining to the State contained in this Official Statement relating to the Offered Veterans G.O. Bonds are true and correct in all material respects and does not and will not contain any untrue statement of a material fact or omit to state any material fact necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading.

STATE OF CALIFORNIA

By: ______________________________
Treasurer of the State of California

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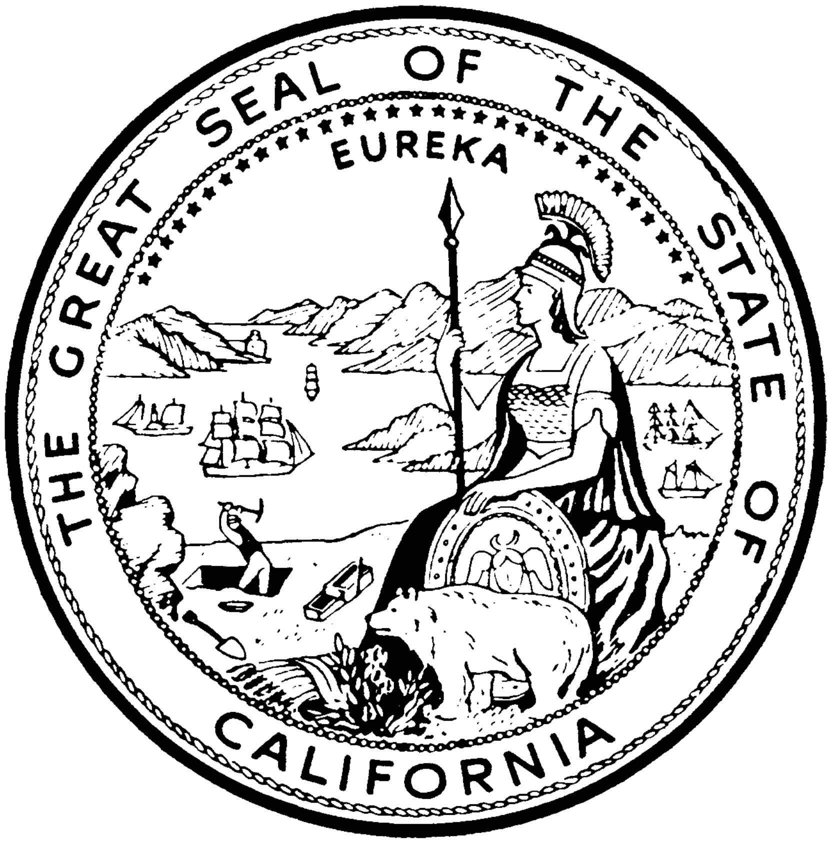
STATE OF CALIFORNIA

By: Terry Lowe for

Treasurer of the State of California

APPENDIX A

THE STATE OF CALIFORNIA



Honorable Philip Angelides
Treasurer of the State of California

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OVERVIEW OF STATE GOVERNMENT

Organization of State Government

The State Constitution provides for three separate branches of government: the legislative, the judicial and the executive. The Constitution guarantees the electorate the right to make basic decisions, including amending the Constitution and local government charters. In addition, the State voters may directly influence State government through the initiative, referendum and recall processes.

California's Legislature consists of a forty-member Senate and an eighty-member Assembly. Assembly members are elected for two-year terms, and Senators are elected for four-year terms. Assembly members are limited to three terms in office and Senators to two terms. The Legislature meets almost year round for a two-year session. The Legislature employs the Legislative Analyst, who provides reports on State finances, among other subjects. The Bureau of State Audits, headed by the State Auditor, an independent office since 1993, annually issues an auditor's report based on an examination of the General Purpose Financial Statements of the State Controller, in accordance with generally accepted accounting principles.

The Governor is the chief executive officer of the State and is elected for a four-year term. The Governor presents the annual budget and traditionally presents an annual package of bills constituting a legislative program. In addition to the Governor, State law provides for seven other statewide elected officials in the executive branch. The current elected statewide officials, their party affiliation and the dates on which they were first elected are as follows:

Office	Name	Party Affiliation	First Elected
Governor	Gray Davis	Democrat	1998
Lieutenant Governor	Cruz Bustamante	Democrat	1998
Treasurer	Philip Angelides	Democrat	1998
Attorney General	Bill Lockyer	Democrat	1998
Controller	Kathleen Connell	Democrat	1994
Secretary of State	Bill Jones	Republican	1994
Superintendent of Public Instruction	Delaine Eastin	Democrat	1994
Insurance Commissioner	Harry Low	Democrat	appointed

The current term for each office expires in January 2003. Persons elected to statewide offices are limited to two terms in office.

The executive branch is principally administered through thirteen major agencies and departments: Business, Transportation and Housing Agency, Child Development and Education Agency, Environmental Protection Agency, Department of Finance, Department of Food and Agriculture, Health and Human Services Agency, Department of Industrial Relations, Resources Agency, State and Consumer Services Agency, Department of Veterans Affairs, Technology, Trade and Commerce Agency, and Youth and Adult Correctional Agency. In addition, some State programs are administered by boards and commissions, such as The Regents of the University of California, Public Utilities Commission, Franchise Tax Board and California

Transportation Commission, which have authority over certain functions of State government with the power to establish policy and promulgate regulations. The appointment of members of boards and commissions is usually shared by the Legislature and the Governor, and often includes ex officio members.

California has a comprehensive system of public higher education comprised of three sectors: the University of California, the California State University System and California Community Colleges. The University of California provides undergraduate, graduate and professional degrees to students. Approximately 44,556 degrees were awarded in the 1999-00 school year. About 167,000 full-time students were enrolled at the nine UC campuses and the Hastings College of Law in the 1999-00 school year. The California State University System, provides undergraduate and graduate degrees to students. Approximately 69,200 degrees were awarded in the 1999-00 school year. About 282,000 full-time students were enrolled at the 23 campuses in the 1999-00 school year. The third sector consists of 108 campuses operated by 72 community college districts which provide associate degrees and certificates. Approximately 104,000 associate degrees and certificates were awarded in the 1999-00 school year. About 1.9 million students were enrolled in California's community colleges in the fall of 2000.

Employee Relations

In 2000-01, the State work force is estimated to be comprised of approximately 316,000 personnel years, of which approximately 108,000 personnel years represent employees of institutions of higher education. Of the remaining 208,000 personnel years, approximately 162,000 are subject to collective bargaining and approximately 46,000 are excluded from collective bargaining. The California State Employees' Association (CSEA) represents 9 of the 21 collective bargaining units, or approximately 52 percent of those employees subject to collective bargaining.

State law provides that State employees, defined as any civil service employee of the State and teachers under the jurisdiction of the Department of Education or the Superintendent of Public Instruction, and excluding certain other categories, have a right to form, join, and participate in the activities of employee organizations for the purpose of representation on all matters of employer-employee relations. The chosen employee organization has the right to represent its members, except that once an employee organization is recognized as the exclusive representative of a bargaining unit, only that organization may represent employees in that unit.

The scope of representation is limited to wages, hours, and other terms and conditions of employment. Representatives of the Governor are required to meet and confer in good faith and endeavor to reach agreement with the employee organization, and, if agreement is reached, to prepare a memorandum of understanding and present it to the Legislature for ratification. The Governor and the recognized employee organization are authorized to agree mutually on the appointment of a mediator for the purpose of settling any disputes between the parties, or either party could request the Public Employment Relations Board to appoint a mediator.

Previous Memoranda of Understanding for all 21 collective bargaining units expired on or before July 2, 2001. As of September 2001, the State reached new agreements with 9 collective bargaining units representing 44,000 employees. The State continues to negotiate with the remaining 12 collective bargaining units representing 118,000 employees. The State has not experienced a major work stoppage in more than 25 years.

RECENT DEVELOPMENTS REGARDING STATE FINANCES

The tragic events of September 11, 2001 have resulted in increased uncertainty regarding the economic and revenue outlook for the State. Past experience suggests that shocks to American society of far lesser severity have resulted in a temporary loss in consumer and business confidence and a reduction in the rate of economic growth. Information released by the Administration in November, 2001 indicated that the State's economy had been slowing prior to September 11, particularly in the high technology sector centered in the Silicon Valley and in the construction sector. The State's economy showed further weakness after that date, and the prospects of a prompt recovery were dimmed as a result of the attacks. Earlier projections were that the State's economy would start to rebound beginning in early 2002, but it now appears likely there will be continued weakness until at least the first half of next year. Nevertheless, the Administration reported that the California economy continued to outperform the nation as a whole.

The slowdown in the California economy, combined with weakness in the stock market, has resulted in a dramatic decline in General Fund revenues compared to the estimates made at the time of the enactment of the 2001-02 Fiscal Year Budget Act (the "2001 Budget Act"). The Department of Finance has reported that, based on preliminary estimates, General Fund revenues measured on a budgetary basis (including accruals) were $614 million below projections for May and June, 2001. For the first four months of the 2001-02 Fiscal Year (July—October), agency cash receipts (excluding accruals) were $827 million below projections. Personal income tax receipts represent $698 million of the current fiscal year shortfall, reflecting weakness in both withholding and estimated tax payments, which include payments relating to capital gains and stock option activity. In addition to reduced revenues, after enactment of the 2001 Budget Act, the Legislature enacted and the Governor signed into law several additional spending bills or tax cuts with an estimated $95 million impact on the General Fund in 2001-02.

In October, 2001, in response to the weak revenue results, the Governor announced a hiring freeze for most State positions and directed State agencies to make cuts in operating expenses totaling at least $150 million in 2001-02 expenditures. The Governor also asked agencies to prepare for cuts of up to 15 percent in expenditures in the 2002-03 fiscal year budget. Most of these actions do not apply to public safety and certain other mandated expenditures.

In further response to the revenue shortfalls, on November 14, 2001 the Governor issued a letter to all State departments and agencies instituting immediate action to further reduce expenditures in the 2001-02 fiscal year. Pending action by the Legislature to cut expenditures, which the Governor will propose in a special session of the Legislature which he will convene in January 2002, the Governor directed agencies to immediately freeze spending on a specified list of programs and projects totaling almost $2.25 billion (including the actions he directed in October). These program cuts and reversions cover almost all areas of State spending, including State operations, aid to local governments and capital outlay. The Governor stated that he had excluded from spending cuts expenditures which could provide short-term stimulus to the State economy.

On November 14, 2001, the Legislative Analyst released a report containing her budget estimates for the period 2001-02 through 2006-07. Included in this report was an estimate that, due to the economic slowdown and a projected severe drop in capital gains and stock option activity, General Fund revenues for the 2001-02 fiscal year would be approximately $68.3 billion, or about $6.8 billion lower than the estimate made for the 2002 Budget Act. The Administration will provide an update of its revenue projections for the 2001-02 and 2002-03 fiscal years when the Governor's Proposed Budget for 2002-03 is released in January, 2002. Both the Department of Finance and the Administration predict that a sharp drop in revenues will occur.

See "Current State Budgets" below for information concerning the 2002 Budget Act and projections made at the time of its enactment. See "State Indebtedness—Cash Flow Borrowings" for information concerning short-term borrowing during the 2001-02 fiscal year.

RECENT DEVELOPMENTS REGARDING ENERGY

Development of the Power Supply Program

In mid-2000, wholesale electricity prices in California began to rise, swiftly and dramatically. Retail electricity rates permitted to be charged by California's investor-owned utilities at the time were frozen by California law. The resulting shortfall between revenues and costs adversely affected the creditworthiness of the investor-owned utilities and their ability to purchase electricity.

In January, 2001, the Governor of California determined that the electricity available from California's utilities was insufficient to prevent widespread and prolonged disruption of electric service in California and proclaimed a state of emergency to exist in California under the California Emergency Services Act. The Governor directed the Department of Water Resources of the State ("DWR") to enter into contracts and arrangements for the purchase and sale of electric power as necessary to assist in mitigating the effects of the emergency (the "Power Supply Program"). Following the Governor's proclamation under the California Emergency Services Act, the Power Supply Program was further authorized by the enactment of legislation (Chapters 4 and 9, First Extraordinary Session of 2001, hereafter referred to as the "Power Supply Act") and the adoption of related orders by the California Public Utilities Commission ("CPUC").

DWR began selling electricity to approximately 10 million retail end-use customers in California (the "Customers") in January, 2001. The Customers are also served by three investor-owned utilities, Pacific Gas and Electric Company ("PG&E"), Southern California Edison Company ("SCE") and San Diego Gas & Electric Company ("SDG&E") (collectively called the "IOUs"). DWR purchases power from wholesale suppliers under long-term contracts and in short-term and spot market transactions. DWR electricity is delivered to the Customers through the transmission and distribution systems of the IOUs and payments from the Customers are collected for DWR by the IOUs pursuant to servicing arrangements ordered by the CPUC.

Financing the Power Supply Program

Between January 17, 2001 and October 31, 2001, DWR committed to spend approximately $11.5 billion under the Power Supply Program. The Power Supply Program has been financed by: (i) unsecured, interest-bearing loans from the General Fund of the State ("State loans") aggregating approximately $6.1 billion; (ii) net proceeds from secured loans from banks and other financial institutions aggregating approximately $4.1 billion ("Interim loans"); and (iii) DWR revenues from power sales to Customers aggregating approximately $2.7 billion through October 31, 2001. As of October 31, 2001, approximately $1.4 billion of proceeds from the Interim loans had not been contractually encumbered and was available for future Power Supply Program commitments. In addition, DWR expects to continue to receive revenues from power sales to Customers which will also be available for future Power Supply Program commitments.

DWR projects that its funds on hand at the date of this Official Statement and projected revenues appear to be sufficient to finance the Power Supply Program on an ongoing basis. This projection is based in part on the assumption that timely and favorable CPUC action will be taken to establish the portion of retail rates charged to Customers for power being sold by DWR as requested by DWR (described under "CPUC Action" below).

The loan agreement for the Interim loans requires principal of the Interim loans to be repaid in eleven quarterly installments commencing on April 30, 2002. Interest is payable at variable rates tied to market indices. Principal and interest are payable solely from revenues from power sales and other funds of the Power Supply Program after provision is made for the payment of power purchase costs and other operating expenses of the Power Supply Program. The Interim loans are not a general obligation of the State and are not repayable from or secured by the General Fund. DWR and the CPUC did not enter into a rate agreement (described under "CPUC Action" below) by October 31, 2001, resulting in an event of noncompliance under the loan agreement that required interest rate increases that are included in DWR's funding projections referred to in the preceding paragraph. The loan agreement includes several other covenants and requirements that DWR may be unable to comply with or fulfill or that are beyond the control of DWR. The loan agreement does not provide for acceleration of scheduled payments of principal and interest on the Interim loans if DWR is not in compliance with the terms of the loan agreement.

The Interim loans were arranged in contemplation of the proposed sale of DWR revenue bonds described in the next paragraph. Net proceeds of the DWR revenue bonds are required to be used first, to repay the Interim loans, and second, to repay the State loans and provide working capital for the Power Supply Program. The timing of the revenue bond sale is uncertain, as explained below. DWR's current revenue requirement (described below under "CPUC Action") is projected to be sufficient to pay scheduled debt service on the Interim loans until at least mid-2003. DWR's ability to make all future payments of principal and interest on the Interim loans if DWR is not able to secure a timely sale of the revenue bonds may depend upon additional rate increases thereafter. DWR plans to repay the State loans from the sale of DWR revenue bonds.

Pursuant to the initial financing arrangements included in the Power Supply Act, DWR is authorized to issue up to $13.4 billion aggregate principal amount of revenue bonds to finance and refinance the Power Supply Program, including repayment of the Interim loans and the State loans. The bonds are to be limited obligations of DWR payable solely from revenues and other funds held under the revenue bond trust indenture after provision is made for the payment of power purchase costs and other operating expenses of the Power Supply Program. Completion of the DWR bond sales under the Power Supply Act has been delayed by a number of factors, including potential legal challenges and the proceedings described below under "CPUC Actions." These delays have moved the earliest potential bond sale date to 2002, and at the date of this Official Statement there is no proposed schedule for the sale.

The State expects to maintain adequate cash reserves to fund its normal operations during the 2001-02 fiscal year whether or not DWR repays the State loans during the fiscal year. See "State Indebtedness—Cash Flow Borrowings."

Power Supply Program after 2002

DWR's Power Supply Program is designed to cover the shortfall between the amount of electricity required by Customers and the amount of electricity furnished to the Customers by the IOUs (the "net short") until December 31, 2002. Thereafter and until the DWR revenue bonds are retired, DWR will sell to Customers the electricity purchased under DWR's long-term contracts. The Administration and the CPUC are developing plans to have the IOUs purchase the balance of any net short after DWR is no longer authorized to do so. Alternatively, it is possible that the Power Supply Program will be extended by legislation or that another State agency will be authorized to develop a successor program.

CPUC Action

Under the California Public Utilities Code, the retail rates of the IOUs are established by the CPUC. The CPUC has authorized substantial rate increases in 2001, but has not yet set the respective rates for DWR and the IOUs. Under the Power Supply Act, DWR is directed to establish, revise and notify the CPUC of its revenue requirements for its sales of electricity and repayment of the DWR revenue bonds at least annually, and more frequently as required. In August DWR submitted its revised revenue requirement to the CPUC. On August 21, 2001, PG&E filed *Pacific Gas and Electric Company v. The California Department of Water*

Resources, et. al., (Sacramento County Superior Court) contesting the DWR determination that its revenue requirement is just and reasonable in the absence of a public hearing. DWR is vigorously defending this case. On October 19, 2001, DWR issued a draft, updated revenue requirement and subsequently held a public workshop to review the draft, updated revenue requirement. In November, 2001, DWR updated its revenue requirement filing with the CPUC, and is awaiting CPUC action thereon.

The Power Supply Act authorizes (but does not require) DWR and the CPUC to enter into a rate agreement pertaining to DWR charges. A proposed order approving such a rate agreement between DWR and the CPUC was rejected by the CPUC on October 2, 2001. The Administration is studying this action, and is considering its options.

On September 6, 2001, the CPUC adopted servicing agreements between DWR and SDG&E and SCE, and a servicing order as to DWR and PG&E pertaining to the delivery of DWR-purchased electricity to Customers through the transmission and distribution systems of the IOUs and the collection of payments for DWR from Customers by the IOUs. PG&E applied to the CPUC for and was denied a rehearing of the servicing agreement decision pertaining to it. PG&E has challenged the servicing agreement decision in Bankruptcy court. See "Litigation – Pacific Gas and Electric Bankruptcy and Adversary Proceedings" below.

On September 20, 2001, the CPUC adopted a decision suspending the right of additional Customers to elect to purchase electricity from suppliers other than DWR and the IOUs until DWR is no longer a supplier of electricity. Applications for rehearing of the order regarding customer choice have been denied by the CPUC. Petitions for writs of review of the customer choice decision have been filed with the California Supreme Court. The Power Supply Act establishes an expedited appeal process, and it is expected that, if accepted by the Court, this matter will be heard within the first quarter of 2002. Also pending before the CPUC are questions regarding the implementation of this customer choice decision, including the date by which the affected Customers must have exercised their election, and what, if any, exit fees may be imposed upon Customers choosing other suppliers.

The timing of CPUC approvals or the effective dates of those approvals may be affected by the PG&E lawsuit referred to above or appeals or litigation brought by IOUs, consumer groups or other interested parties. Although under State law, appeals and litigation of CPUC actions related to the Power Supply Program must be granted an expedited appeal process, there can be no assurance that any such appeals or litigation will not delay the issuance of DWR's revenue bonds or the implementation of DWR's rates.

Litigation

A number of lawsuits and regulatory proceedings have been commenced concerning various aspects of the current energy situation. These include disputes over rates set by the CPUC; responsibility for the electricity and natural gas purchases made by the IOUs and the California Independent Systems Operator ("ISO"); continuing contractual obligations of certain small independent power generators; and antitrust and fraud claims against various parties. These actions do not seek a judgment against the State's General Fund, and in some cases neither the

State nor the DWR is even a party to these actions. However, these cases may have an impact on the price or supply of energy in California.

Actions Contesting DWR's Revenue Requirement and Power Contracts

See the discussion above under "CPUC Action" relating to *Pacific Gas and Electric Company v. The California Department of Water Resources, et al.* (Sacramento County Superior Court).

The CPUC has filed with the Federal Energy Regulatory Commission ("FERC") protests as to the reasonableness of several of the long-term contracts pursuant to which DWR has been purchasing power for sale to Customers. The California Electricity Oversight Board ("CEOB") has also filed a protest as to the reasonableness of one of the DWR long-term contracts. The CEOB is a state board responsible for, among other things, representing the State before FERC. Should these contracts be determined by FERC to not be just and reasonable, it could result in a change to the rates or the terms and conditions of those contracts.

In *Carboneau v. State of California et al.*, filed on November 9, 2001 in Sacramento Superior Court, plaintiff alleges that he intends to bring suit as the representative of a class of persons who have suffered rate increases as a result of power contracts entered into between the State and certain power companies. The plaintiff makes factual allegations that include, among others, allegations that certain named defendants who participated in the contract process had conflicts of interest. The plaintiff pleads, among other things, that in negotiating these power contracts defendants engaged in unfair business practices and violated anti-trust laws and the Consumer Legal Remedies Act. Plaintiff seeks declaratory and injunctive relief as well as damages, with a main objective being to have all electricity contracts entered into by the DWR since January 2001 declared void as against public policy. Such declaration could delay the issuance of DWR revenue bonds or the acquisition of other financing.

Action Requiring DWR to pay for Power Ordered for PG&E and SCE

FERC has exclusive jurisdiction over the wholesale electric power market in the United States and the rates, terms, and conditions of service of the California Independent Systems Operator ("ISO"), the operator of the high-voltage system transmission system in California that supplies power to California utilities. FERC adopted a mitigation program for the California energy market in mid-2001 with the objective or ensuring just and reasonable wholesale electricity prices. One element of the program is that generators are required to offer to sell electricity to the ISO. Pursuant to the ISO's tariff, all of its utility customers must be creditworthy. PG&E and SCE do not meet the creditworthiness requirements, and DWR has been serving as the creditworthy party backing purchases of the net short power supply for PG&E and SCE. DWR has not been making payments to the ISO for a portion of those purchases because neither invoices nor adequate invoice backup information had been provided to DWR. Resulting delays in payments to generators by the ISO have prompted FERC proceedings, and a FERC order issued on November 7, 2001 (FERC Docket Nos. ER01-3013 and ER01-889-002), stated that FERC's must-offer requirement assumes a must-pay requirement and directed the ISO to require payment of overdue amounts from DWR within three months. On November 20, 2001, the ISO submitted to DWR an invoice which the ISO represented as being for all amounts past due from the ISO, in the amount of $956 million. DWR previously set aside approximately $1 billion (and may set aside additional funds) to pay for the net short power supply in dispute.

Action Challenging the Governor's Authority to Commandeer Block Forward Contracts

In Duke Energy Trading and Marketing v. Davis, et al. (U.S. District Court, C.D. Cal.), the plaintiff challenges the Governor's orders commandeering SCE and PG&E block forward market contracts held by the California Power Exchange ("Power Exchange" or "PX") on the ground that the orders violated the Supremacy Clause and other constitutional provisions. (See "*Other Energy-Related Bankruptcies*" below for a brief description of the Power Exchange.) Duke Energy seeks a temporary restraining order ("TRO") and injunction barring the Governor from taking any action against Duke Energy under the authority of the Executive Orders and a declaration that Duke Energy has no obligation to deliver power under the block forward contracts. On April 30, 2001, the U.S. District Court granted Governor Davis' motion to dismiss plaintiff's complaint based on Eleventh Amendment immunity and denied plaintiff's motions for partial summary judgment.

On September 20, 2001, the United States Court of Appeals for the Ninth Circuit, in a 2-1 opinion, reversed the district court's judgment. The Court found that the Ex parte Young exception to the Eleventh Amendment applied and that the Governor's interference with the block forward contracts' security provisions was preempted by the federal scheme established by FERC. Accordingly, the Court remanded the case to the district court with instructions that judgment be entered in favor of Duke Energy and that an appropriately tailored injunction against Governor Davis' commandeering orders be entered. On October 11, 2001, the Governor filed a petition for rehearing en banc. The monetary impact of a final adverse decision is unknown. (See "Litigation -- Litigation Relating to Energy Matters -- *Actions Seeking Compensation for Block Forward Contracts Commandeered by the Governor*" for discussion of related legal action.)

Pacific Gas and Electric Bankruptcy and Related Adversary Proceedings

On April 6, 2001, PG&E filed a voluntary Chapter 11 bankruptcy petition in U.S. Bankruptcy Court for the Northern District of California, San Francisco Division (*In re Pacific Gas and Electric*, U.S. Bankruptcy Court, N.D. Cal.). The State has filed numerous claims as a creditor of PG&E, including but not limited to, claims for income and property taxes, regulatory fees, fines and penalties and environmental fees, fines and penalties.

DWR has filed administrative claims for post-petition purchases of electricity on PG&E's behalf, arising from the sale of electric energy or services for the customers of PG&E for the period April 7, 2001, through June 30, 2001, in an estimated amount of approximately $179 million. Claims for amounts due for July and beyond, if any, may be filed. DWR has also filed claims for pre-petition power-related matters in the estimated amount of approximately $225 million.

On September 20, 2001, PG&E filed its plan of reorganization. The plan seeks an extensive restructuring of PG&E's business and the transfer of certain of its assets, including its electric and gas transmission assets, to newly created limited liability companies. The plan states that PG&E will seek to establish conditions to PG&E's resumption of its responsibility for the power currently being provided its customers by DWR, and a ruling to prohibit it from accepting an assignment of any of DWR's long-term power purchase contracts. The State, including DWR, and the CPUC have objected to aspects of the plan of reorganization and PG&E's disclosure statement of the plan. The hearing on the disclosure statement of the plan is tentatively set for December 19, 2001.

On April 9, 2001, PG&E filed an adversary proceeding in the bankruptcy court seeking declaratory and injunctive relief against the CPUC and its current Commissioners in their respective capacities to prevent the CPUC from implementing or enforcing any order that requires PG&E to make certain transfers between certain regulatory accounts which track PG&E revenues and costs. PG&E asserts that such an order would have the effect of extending the rate freeze presently in effect, and delaying the time when PG&E can seek rates sufficient to recover its costs of obtaining power. The bankruptcy court has dismissed this complaint with prejudice and denied PG&E's motion for preliminary injunction ruling that (1) sovereign immunity applies to the CPUC, but not to the Commissioners and (2) the automatic stay does not apply to the challenged actions of the Commissioners because those actions constitute an exercise of the CPUC's police and regulatory power. Cross-appeals have been taken to the U.S. District Court, in *Pacific Gas and Electric Company (PG&E v. CPUC)* U.S. Bankruptcy Court, Northern District of California, San Francisco Division, No. 0130923(DM). The parties have filed a stipulated briefing schedule with the court, which provides for briefs to be filed during the remaining months of 2001.

On September 26, 2001, PG&E sought an order from the bankruptcy court authorizing PG&E to decline to comply with a CPUC order to enter into and implement the "Servicing Agreement" with DWR which provides that PG&E will supply distribution and billing services to allow DWR to deliver its power to retail end users and receive payment therefor. PG&E contends that CPUC order is tantamount to a diversion of the assets of the bankrupt estate which would be detrimental to the estate and its reorganization efforts. A hearing on the matter is set for January 3, 2002.

Other Energy-Related Bankruptcies

SCE has previously indicated that it might seek bankruptcy law protection. On October 2, 2001, SCE and the CPUC announced the proposed settlement of certain pending litigation which is intended to allow SCE to recover from ratepayers a substantial portion of its accumulated debts. The settlement was approved by the federal District Court on October 5, 2001. A consumer group has appealed that decision. The group's motions for stay of judgment pending appeal have been denied by both the district court (upon remand) and the appellate court. Oral argument in the appeal is currently scheduled for March, 2002.

The Power Exchange filed for protection under Chapter 11 of the Bankruptcy Code on March 9, 2001 (U. S. Bankruptcy Court, Central District of California, No. LA01-16577-ES). The PX formerly served as an independent, non-profit entity responsible for administering the competitive wholesale electricity market in California during the period when the IOUs were required to sell all output of their retained power supply resources to the PX and make all purchases of electric energy needed to serve their retail end use customers from the PX. After a December, 2000 FERC order permitting the IOUs to purchase and sell other than through the PX, PX operations slowed dramatically. The PX suspended trading in its power markets on January 31, 2001. On November 14, 2001, participating creditors filed a disclosure statement and a plan of reorganization for the PX.

Prospects

Since January, 2001, the Governor and Legislature have implemented a number of steps through new laws and Executive Orders to respond to the energy problems in the State. These steps include expediting power plant construction and other means of increasing electricity supplies, implementing vigorous energy conservation programs, and entering into long-term power supply and natural gas supply contracts to reduce reliance on spot markets. The Administration believes the combination of these steps, along with moderate temperatures, allowed the State to avoid any electricity interruptions during the peak summer energy demand season.

While the State expects that over time the measures described above, coupled with conservation, load management and improved energy efficiency, will continue to enable the State to avoid disruptions of the supply of electricity to the public, and will maintain lower wholesale power prices and ultimately promote the financial recovery of the IOUs, the situation continues to be fluid and subject to many uncertainties. There can be no assurance that there will not be future disruptions in power supplies or related developments which could adversely affect the State's economy, and which could in turn affect State revenues, or the health and comfort of its citizens.

STATE INDEBTEDNESS

General

The State Treasurer is responsible for the sale of debt obligations of the State and its various authorities and agencies. The State has always paid the principal of and interest on its general obligation bonds, general obligation commercial paper notes, lease-purchase debt and short-term obligations, including revenue anticipation notes and revenue anticipation warrants, when due.

Capital Facilities Financing

General Obligation Bonds - The State Constitution prohibits the creation of general obligation indebtedness of the State unless a bond law is approved by a majority of the electorate voting at a general election or a direct primary. General obligation bond acts provide that debt service on general obligation bonds shall be appropriated annually from the General Fund and all debt service on general obligation bonds is paid from the General Fund. Under the State Constitution, debt service on general obligation bonds is the second charge to the General Fund after the application of moneys in the General Fund to the support of the public school system and public institutions of higher education. See "State Finances – State Expenditures" below. Certain general obligation bond programs receive revenues from sources other than the sale of bonds or the investment of bond proceeds.

As of September 1, 2001, the State had outstanding $23,215,938,000 aggregate principal amount of long-term general obligation bonds, and unused voter authorizations for the future issuance of $10,937,499,000 of long-term general obligation bonds. This latter figure consists of $4,144,034,000 of authorized commercial paper notes, described below (of which $763,945,000 was outstanding), which had not yet been refunded by general obligation bonds, and $6,793,465,000 of other authorized but unissued general obligation debt (including the most recent voter authorizations). See the table "Authorized and Outstanding General Obligation Bonds" under "State Debt Tables" below. Two bond proposals for $2.8 billion will appear on the March, 2002 primary election ballot.

The General Obligation Bond Law permits the State to issue as variable rate indebtedness up to 20 percent of the aggregate amount of long-term general obligation bonds outstanding. As of September 1, 2001, there was no variable rate indebtedness outstanding; however, the State plans to issue such indebtedness in the future.

Commercial Paper Program - Pursuant to legislation enacted in 1995, voter approved general obligation indebtedness may be issued either as long-term bonds, or, for some but not all bond acts, as commercial paper notes. Commercial paper notes may be renewed or may be refunded by the issuance of long-term bonds. The State issues long-term general obligation bonds from time to time to retire its general obligation commercial paper notes. Pursuant to the terms of the bank credit agreement presently in effect supporting the general obligation commercial paper program, not more than $1.5 billion of general obligation commercial paper notes may be outstanding at any time; this amount may be increased or decreased in the future. Commercial paper notes are deemed issued upon authorization by the respective Finance Committees, whether or not such notes are actually issued. As of September 1, 2001, the Finance Committees had authorized the issuance of up to $4,144,034,000 of commercial paper notes; as of that date $763,945,000 aggregate principal amount of general obligation commercial paper notes was outstanding.

Lease-Purchase Debt - In addition to general obligation bonds, the State builds and acquires capital facilities through the use of lease-purchase borrowing. Under these arrangements, the State Public Works Board, another State or local agency or a joint powers authority issues bonds to pay for the construction of facilities such as office buildings, university buildings or correctional institutions. These facilities are leased to a State agency or the University of California under a long-term lease which provides the source of payment of the debt service on the lease-purchase bonds. In some cases, there is not a separate bond issue, but a trustee directly creates certificates of participation in the State's lease obligation, which are marketed to investors. Under applicable court decisions, such lease arrangements do not constitute the creation of "indebtedness" within the meaning of the Constitutional provisions which require voter approval. For purposes of this section of the Official Statement and the tables under "State Debt Tables" below, "lease-purchase debt" or "lease-purchase financing" means principally bonds or certificates of participation for capital facilities where the rental payments providing the security are a direct or indirect charge against the General Fund and also includes revenue bonds for a State energy efficiency program secured by payments made by various State agencies under energy service contracts. Certain of the lease-purchase financings are supported by special funds rather than the General Fund (see "State Finances--Sources of Tax Revenue"). The tables do not include equipment leases or leases which were not sold, directly or indirectly, to the public capital markets. The State had $6,332,099,641 General Fund-supported lease-purchase debt outstanding at September 1, 2001. The State Public Works Board, which is authorized to sell lease revenue bonds, had $2,955,937,000 authorized and unissued as of September 1, 2001.

Non-Recourse Debt - Certain State agencies and authorities issue revenue obligations for which the General Fund has no liability. Revenue bonds represent obligations payable from State revenue-producing enterprises and projects, which are not payable from the General Fund, and conduit obligations payable only from revenues paid by private users of facilities financed by the revenue bonds. The enterprises and projects include transportation projects, various public works projects, public and private educational facilities (including the California State University and University of California systems), housing, health facilities and pollution control facilities. There are 17 agencies and authorities authorized to issue revenue obligations (excluding lease-purchase debt). State agencies and authorities had $29,034,926,224 aggregate principal amount of revenue bonds and notes which are non-recourse to the General Fund outstanding as of June 30, 2001, as further described in the table "State Agency Revenue Bonds and Conduit Financing" under "State Debt Tables" below.

Detailed tables showing the State's long-term debt appear in the section "State Debt Tables" below.

Cash Flow Borrowings

As part of its cash management program, the State has regularly issued short-term obligations to meet cash flow needs. The following table shows the amount of revenue anticipation notes ("Notes") issued over the past five fiscal years and the current year. See "Prior Fiscal Years' Financial Results" and "Current State Budgets" below.

State of California Revenue Anticipation Notes Issued
Fiscal Years 1996-97 to 2001-02

Fiscal Year	Type	Principal Amount (Billions)	Date of Issue	Maturity Date
1996-1997	Notes Series A-C	$3.0	August 6, 1996	June 30, 1997
1997-1998	Notes	3.0	September 9, 1997	June 30, 1998
1998-1999	Notes	1.7	October 1, 1998	June 30, 1999
1999-2000	Notes Series A-B	1.0	October 1, 1999	June 30, 2000
2000-2001	No Notes issued			
2001-2002	Notes Series A-C	5.7	October 4, 2001	June 28, 2002

SOURCE: State of California, Office of the Treasurer.

The State issued $5.7 billion of 2001-02 Revenue Anticipation Notes (the "2001 RANs") on October 4, 2001, to mature on June 28, 2002. The 2001 RANs are payable from any "Unapplied Money" in the General Fund of the State on the maturity date, subject to the prior application of such money to support the public school system and public institutions of higher education, to pay debt service on State general obligation bonds and commercial paper notes, and to reimburse other State special funds, to the extent required by law, for internal borrowings. See "State Finances" below. At the time of the issuance of the 2001 RANs, the State projected that there would be sufficient moneys in the General Fund at June 28, 2002, including available internal borrowings from State special funds, to pay the 2001 RANs, even if the General Fund did not receive payment of $6.3 billion for moneys loaned (including interest) to the DWR Power Purchase Program during the past year. See "Recent Developments Regarding Energy" above. In the event the State Controller determines the General Fund would not have sufficient moneys to repay the 2001 RANs, the State has several alternate means of obtaining additional cash resources. See "State Finances – State Warrants" below. The State has never failed to pay any of its short-term cash flow borrowings when due. Unaudited statements of cash receipts and disbursements for the period July 1, 2001 – October 31, 2001 are attached as Exhibit 2 to this Appendix A. See "Financial Statements" below. These results are not necessarily indicative of cash receipts and disbursements for the balance of the fiscal year. See "Recent Developments Regarding State Finances" above.

STATE FINANCES

The Budget Process

The State's fiscal year begins on July 1 and ends on June 30. The State operates on a budget basis, using a modified accrual system of accounting, with revenues credited in the period in which they are measurable and available and expenditures debited in the period in which the corresponding liabilities are incurred.

The annual budget is proposed by the Governor by January 10 of each year for the next fiscal year (the "Governor's Budget"). Under State law, the annual proposed Governor's Budget cannot provide for projected expenditures in excess of projected revenues and balances available from prior fiscal years. Following the submission of the Governor's Budget, the Legislature takes up the proposal.

Under the State Constitution, money may be drawn from the Treasury only through an appropriation made by law. The primary source of the annual expenditure authorizations is the Budget Act as approved by the Legislature and signed by the Governor. The Budget Act must be approved by a two-thirds majority vote of each House of the Legislature. The Governor may reduce or eliminate specific line items in the Budget Act or any other appropriations bill without vetoing the entire bill. Such individual line-item vetoes are subject to override by a two-thirds majority vote of each House of the Legislature.

Appropriations also may be included in legislation other than the Budget Act. Bills containing appropriations (except for K-14 education) must be approved by a two-thirds majority vote in each House of the Legislature and be signed by the Governor. Bills containing K-14 education appropriations only require a simple majority vote. Continuing appropriations, available without regard to fiscal year, may also be provided by statute or the State Constitution. There is litigation pending concerning the validity of such continuing appropriations. See "Litigation" below.

Funds necessary to meet an appropriation need not be in the State Treasury at the time such appropriation is enacted; revenues may be appropriated in anticipation of their receipt.

The General Fund

The moneys of the State are segregated into the General Fund and over 900 special funds, including bond, trust and pension funds. The General Fund consists of revenues received by the State Treasury and not required by law to be credited to any other fund, as well as earnings from the investment of State moneys not allocable to another fund. The General Fund is the principal operating fund for the majority of governmental activities and is the depository of most of the major revenue sources of the State. For additional financial data relating to the General Fund, see Exhibit 1 to this Appendix A. The General Fund may be expended as a consequence of appropriation measures enacted by the Legislature and approved by the Governor, as well as appropriations pursuant to various constitutional authorizations and initiative statutes.

The Special Fund for Economic Uncertainties

The Special Fund for Economic Uncertainties ("SFEU") is funded with General Fund revenues and was established to protect the State from unforeseen revenue reductions and/or unanticipated expenditure increases. Amounts in the SFEU may be transferred by the State Controller to the General Fund as necessary to meet cash needs of the General Fund. The State Controller is required to return moneys so transferred without payment of interest as soon as there are sufficient moneys in the General Fund. At the end of each fiscal year, the Controller is required to transfer from the SFEU to the General Fund any amount necessary to eliminate any deficit in the General Fund.

The legislation creating the SFEU (Government Code Section 16418) contains a continuous appropriation from the General Fund authorizing the State Controller to transfer to the SFEU, as of the end of each fiscal year, the lesser of (i) the unencumbered balance in the General Fund and (ii) the difference between the State's "appropriations subject to limitation" for the fiscal year then ended and its "appropriations limit" as defined in Section 8 of Article XIII B of the State Constitution and established in the Budget Act for that fiscal year, as jointly estimated by the State's Legislative Analyst's Office and the Department of Finance. For a further description of Article XIII B, see "State Appropriations Limit" below. In certain circumstances, moneys in the SFEU may be used in connection with disaster relief.

For budgeting and accounting purposes, any appropriation made from the SFEU is deemed an appropriation from the General Fund. For year-end reporting purposes, the State Controller is required to add the balance in the SFEU to the balance in the General Fund so as to show the total moneys then available for General Fund purposes.

See the caption "Current State Budgets" below for information concerning the recent balances in the SFEU and projections of the balances for the current and upcoming fiscal years. As in any year, the Budget Act and related trailer bills are not the only pieces of legislation which appropriate funds. Other factors including re-estimates of revenues and expenditures, existing statutory requirements, and additional legislation introduced and passed by the Legislature may impact the reserve amount.

Inter-Fund Borrowings

Inter-fund borrowing is used to meet temporary imbalances of receipts and disbursements in the General Fund. As of June 30, 2001, the General Fund had no outstanding loans from the SFEU, General Fund special accounts or other special funds.

In the event the General Fund is or will be exhausted, the State Controller is required to notify the Governor and the Pooled Money Investment Board (the "PMIB," consisting of the State Director of Finance, the State Treasurer and the State Controller). The Governor may then order the State Controller to direct the transfer of all or any part of the moneys not needed in special funds to the General Fund from such special funds, as determined by the PMIB. All money so transferred must be returned to the special fund from which it was transferred as soon as there is sufficient money in the General Fund to do so. Transfers cannot be made from a special fund which will interfere with the objective for which such special fund was created, or from certain specific funds. When moneys transferred to the General Fund in any fiscal year from any special fund pursuant to the inter-fund borrowing mechanism exceed ten percent of the total additions as shown in the statement of operations of the preceding fiscal year as set forth in the Budgetary (Legal Basis) annual report of the State Controller, interest must be paid on such excess at a rate determined by the PMIB to be the current earning rate of the Pooled Money Investment Account.

Although any determination of whether a proposed borrowing from one of the special funds is permissible, any such determination must be made with regard to the facts and circumstances existing at the time of the proposed borrowing. The Attorney General of the State has identified certain criteria relevant to such a determination. For instance, amounts in the special funds eligible for inter-fund borrowings are legally available to be transferred to the General Fund if a reasonable estimate of expected General Fund revenues, based upon legislation already enacted, indicates that such transfers can be paid from the General Fund promptly if needed by the special funds or within a short period of time if not needed. In determining whether this requirement has been met, the Attorney General has stated that consideration may be given to the fact that General Fund revenues are projected to exceed expenditures entitled to a higher priority than payment of internal transfers, i.e., expenditures for the support of the public school system and public institutions of higher education and the payment of debt service on general obligation bonds of the State.

At the November 1998 election voters approved Proposition 2. This proposition requires the General Fund to repay loans made from certain transportation special accounts (such as the State Highway Account) at least once per fiscal year, or up to 30 days after adoption of the annual budget act. Since the General Fund may reborrow from the transportation accounts soon after the annual repayment is made, the proposition is not expected to have any adverse impact on the State's cash flow.

The following chart shows internal borrowable resources available for temporary loans to the General Fund on June 30 of each of the fiscal years 1997-98 through 2000-01 and estimates for 2001-02:

Internal Borrowable Resources
(Cash Basis)
(Millions)

	June 30				
	1998	**1999**	**2000**	**2001**	**2002***
Available Internal Borrowable Resources	$6,866.8	$8,720.0	$9,427.2	$12,342.4	$10,634.3
Outstanding Loans					
From Special Fund for Economic Uncertainties	-0-	-0-	-0-	-0-	1,503.4
From Special Funds and Accounts	-0-	-0-	-0-	-0-	-0-
Total Outstanding Internal Loans	-0-	-0-	-0-	-0-	1,503.4
Unused Internal Borrowable Resources	$6,866.8	$8,720.0	$9,427.2	$12,342.4	$9,130.9

*Estimated. This estimate will be updated when the Governor's 2002-03 Budget is released on January 10, 2002. See "Recent Developments Regarding State Finances."
SOURCE: State of California, Office of the State Controller and State of California, Department of Finance. Information for the fiscal years ended June 30, 1998 through June 30, 2001 are actual figures. For the fiscal year ending June 30, 2002, these figures were estimated as of August 22, 2001 by the Department of Finance.

State Warrants

No money may be drawn from the State Treasury except upon a warrant duly issued by the State Controller. The State Controller is obligated to draw every warrant on the fund out of which it is payable for the payment of money directed by State law to be paid out of the State Treasury; however, a warrant may not be drawn unless authorized by law and unless unexhausted specific appropriations provided by law are available to meet it. State law provides two methods for the State Controller to respond if the General Fund has insufficient "Unapplied Money" available to pay a warrant when it is drawn, referred to generally as "registered warrants" and "reimbursement warrants." "Unapplied Money" consists of money in the General Fund for which outstanding warrants have not already been drawn and which would remain in the General Fund if all outstanding warrants previously drawn and then due were paid. Unapplied Money may include moneys transferred to the General Fund from the SFEU and internal borrowings from the Special Funds (to the extent permitted by law).

If a warrant is drawn on the General Fund for an amount in excess of the amount of Unapplied Money in the General Fund, after deducting from such Unapplied Money the amount, as estimated by the State Controller, required by law to be set apart for obligations having priority over obligations to which such warrant is applicable, the warrant must be registered by the State Treasurer on the reverse side as not paid because of the shortage of funds in the General Fund. The State Controller then delivers such a "registered warrant" to persons or entities (e.g., employees, suppliers and local governments) otherwise entitled to receive payments from the State. A registered warrant bears interest at a rate designated by the PMIB up to a maximum of 5 percent per annum. Registered warrants have no fixed maturity date, but are redeemed when the Controller, with the approval of the PMIB, determines there would be sufficient Unapplied Money in the General Fund. The State Controller notifies the State Treasurer, who publishes a notice that the warrants in question are payable.

In lieu of issuing individual registered warrants to numerous creditors, there is an alternative procedure through which the State may borrow money to meet its cash flow requirements. Under this procedure, the Governor, upon request of the State Controller, may create a General Cash Revolving Fund in the State Treasury which may borrow from other State special funds to meet payments authorized by law. The State Controller may then issue "reimbursement warrants" to public investors at competitive bid to reimburse the General Cash Revolving Fund, thereby increasing cash resources for the General Fund to cover required payments. The General Cash Revolving Fund is created solely to facilitate the issuance of registered reimbursement warrants. Reimbursement warrants have a fixed maturity date, which may be in a fiscal year following the year in which they are issued, and must be paid by the State Treasurer on their maturity date from any Unapplied Money in the General Fund and available therefor. In the past two decades, reimbursement warrants have been the preferred method for the State Controller to increase cash resources, because reimbursement warrants are a more efficient method of raising funds, and because recent court decisions have limited to some extent the types of payments for which registered warrants may be used.

The State issued reimbursement warrants on several occasions in order to meet its cash needs during the period 1992-1994, when State revenues were severely reduced because of an economic recession.

Investment of Funds

Moneys on deposit in the State's Centralized Treasury System are invested by the Treasurer in the Pooled Money Investment Account (the "PMIA"). As of September 30, 2001, the PMIA held approximately $30.62 billion of State moneys, and $18.28 billion of moneys invested for about 2,984 local governmental entities through the Local Agency Investment Fund ("LAIF"). The assets of the PMIA as of September 30, 2001, are shown in the following table:

Analysis of the Pooled Money Investment Account Portfolio*

Type of Security	Amount (Millions)	Percent of Total
U.S. Treasury Bills and Notes	$ 5,140	10.5%
Commercial Paper (corporate)	9,840	20.1
Certificates of Deposits	6,960	14.2
Corporate Bonds	2,404	4.9
Federal Agency Securities	15,112	30.8
Bankers Acceptances	--	0.0
Bank Notes	1,425	2.9
Loans Per Government Code	3,267	6.7
Time Deposits	4,844	9.9
Repurchases	--	0.0
Reverse Repurchases	--	0.0
	$48,992	100%

*Totals may not add due to rounding.
SOURCE: State of California, Office of the Treasurer.

The State's treasury operations are managed in compliance with the California Government Code and according to a statement of investment policy which sets forth permitted investment vehicles, liquidity parameters and maximum maturity of investments. The PMIA operates with the oversight of the PMIB (consisting of the State Treasurer, the State Controller and the Director of Finance). The LAIF portion of the PMIA operates with the oversight of the Local Agency Investment Advisory Board (consisting of the State Treasurer and four other appointed members).

The Treasurer does not invest in leveraged products or inverse floating rate securities. The investment policy permits the use of reverse repurchase agreements subject to limits of no more than 10 percent of the PMIA. All reverse repurchase agreements are cash matched either to the maturity of the reinvestment or an adequately positive cash flow date which is approximate to the maturity of the reinvestment. The PMIA does not hold any investments in obligations of California investor-owned utilities.

The average life of the investment portfolio of the PMIA as of September 30, 2001 was 169 days.

Pension Trusts

The pension contribution liability for the three principal retirement systems in which the State participates, the California Public Employee's Retirement System ("CalPERS"), the California State Teachers' Retirement System ("CalSTRS") and the University of California Retirement System ("UCRS"), is included in the financial statements of the State and described in Note 23, Tables 29 and 30 of Notes to the Audited General Purpose Financial Statements of the State of California for the year ended June 30, 2000 (the "Audited Financial Statements"), which are incorporated in this Official Statement.

The three largest defined benefit retirement plans contained in the retirement systems and the State's share of the excess of the actuarial value of assets over the actuarial accrued liability of those plans at June 30, 2000 was reported to be as follows:

Name of Plan	Excess of Actuarial Value of Assets Over Actuarial Accrued Liabilities
Public Employees' Retirement Fund	$ 6.425 billion
State Teachers' Retirement Fund	9.101 billion
University of California Retirement Plan	12.959 billion

Because the actuarial value of assets exceeded the actuarial accrued liability of the plans as shown in this table, the net pension obligation of the State as of June 30, 2000 was reported as zero for each of the three plans. Accordingly, at present, State contributions to the three plans consist only of current contributions calculated as a percentage of employee compensation. There is no assurance that this situation will continue because investment returns and other factors affecting the assets and liabilities of the plans will change over time, and at some point in the future, as in the past, the State may have to make payments to the retirement systems to cover actuarial accrued liabilities in excess of the actuarial value of assets.

Details concerning the three largest plans and information concerning the other plans contained in the retirement systems are included in Note 23 to the Audited Financial Statements. See "Financial Statements" below.

Welfare Reform

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (P.L. 104-193, the "Law") fundamentally reformed the nation's welfare system. The Law includes provisions to: (i) convert Aid to Families with Dependent Children ("AFDC"), an entitlement program, to Temporary Assistance for Needy Families ("TANF"), a block grant program with lifetime time limits on TANF recipients, work requirements and other changes; (ii) deny certain federal welfare and public benefits to legal noncitizens (subsequent federal law has amended this provision), allow states to elect to deny additional benefits (including TANF) to legal noncitizens, and generally deny almost all benefits to illegal immigrants; and (iii) make changes in the Food Stamp program, including to reduce maximum benefits and impose work requirements. The block grant formula under the Law is operative through federal fiscal year 2002.

Chapter 270, Statutes of 1997, embodies California's response to the federal welfare reforms. Effective January 1, 1998, California Work Opportunity and Responsibility to Kids ("CalWORKs") replaced the former AFDC and Greater Avenues to Independence programs. Consistent with the federal law, CalWORKs contains time limits on the receipt of welfare aid, both lifetime as well as current period. The centerpiece of CalWORKs is the linkage of eligibility to work participation requirements.

Administration of the CalWORKs program is largely at the county level, and the counties receive financial incentives for success in this program. Beginning in 2000-01, county performance incentive earnings are subject to Budget Act appropriation. The 2000 Budget Act included $250 million for incentives. It was anticipated that this entire amount, plus an additional appropriation in 2001-02, would be needed to pay county incentives earned prior to 2000-01. However, it is now estimated that only $97 million is needed to pay the entire amount earned prior to 2000-01, leaving $153 million for other purposes. Under the provisions of the 2000 Budget Act, this $153 million would remain available for incentive payments. However, CalWORKs program funding needs have since increased primarily due to increased caseload as compared to previous estimates. As a result, the 2000 Budget Act was amended to specify that no funds appropriated in that Budget Act shall be for payment of CalWORKs county performance incentives. This allows the 2000-01 performance incentive appropriation to be redirected to fund more critical program components in 2001-02. The 2001-02 CalWORKs budget contains $20 million for incentives earned prior to 2000-01, but no funding for new incentive earnings. This leaves $77 million in incentives earned prior to 2000-01 which may need to be paid at a later point in time.

Welfare caseloads have continued to decline with the implementation of the CalWORKs program. The 2001-02 CalWORKs caseload is projected to be 512,000, down from 528,000 cases in 2000-01 and a high of 921,000 cases in 1994-95. The longer-term impact of the new federal law and CalWORKs is being evaluated by the RAND Corporation, with a series of reports to be furnished and the final report due October 2001.

The 2000-01 CalWORKs budget reflects California's success in meeting the federally-mandated work participation requirements for federal fiscal years 1997, 1998, and 1999. Having met that goal, the federally-imposed maintenance-of-effort ("MOE") level for California was reduced from 80 percent of the federal fiscal year 1994 baseline expenditures for the former AFDC program ($2.9 billion) to 75 percent ($2.7 billion). It is expected that California will continue to meet the work participation goal in federal fiscal year 2000 and beyond. Recently the State successfully appealed a federal decision that California did not meet the 1997 work participation requirement. As a result, the State's General Fund expenditures in the CalWORK's program were reduced on a one-time basis by an additional $153.9 million for 2000-01 to reflect the lower 1997 MOE requirement, saving a corresponding amount for use in other programs.

In addition, California received a TANF High Performance Bonus award of $36.1 million in 2000-01. This one-time bonus is awarded to states for their successes in moving welfare recipients to work and sustaining their participation in the workforce.

In 2001-02, California will continue to meet, but not exceed, the federally-required $2.7 billion combined State and county MOE requirement. The Budget includes total CalWORKs-related expenditures of $7.3 billion for 2001-02, including child care transfer amounts for the Department of Education and the general TANF Block Grant reserve.

Local Governments

The primary units of local government in California are the counties, which range in population from 1,200 in Alpine County to approximately 9,800,000 in Los Angeles County. Counties are responsible for the provision of many basic services, including indigent health care, welfare, jails and public safety in unincorporated areas. There are also 476 incorporated cities, and thousands of special districts formed for education, utility and other services. The fiscal condition of local governments has been constrained since "Proposition 13" was enacted by California voters in 1978. Proposition 13 reduced and limited the future growth of property taxes and limited the ability of local governments to impose "special taxes" (those devoted to a specific purpose) without two-thirds voter approval. Counties, in particular, have had fewer options to raise revenues than many other local government entities and have been required to maintain many services.

In the aftermath of Proposition 13, the State provided aid to local governments from the General Fund to make up some of the loss of property tax moneys, including taking over the principal responsibility for funding K-12 schools and community colleges. During the recession of the early 1990s, the Legislature eliminated most of the remaining components of post-Proposition 13 aid to local government entities other than K-14 education districts by requiring cities and counties to transfer some of their property tax revenues to school districts. However, the Legislature also provided additional funding sources (such as sales taxes) and reduced certain mandates for local services. Local governments sued the State (*Sonoma County, et. al. v. Commission on State Mandates, et. al)* over these transfers. The appeals court denied the plaintiffs' position and the subsequent appeal was not heard by the State Supreme Court.

The 2001 Budget Act and related legislation provide significant assistance to local governments, including $357 million for various local public safety programs, including the Citizens' Option for Public Safety ("COPS") program to support local front-line law enforcement, sheriffs' departments for jail construction and operations, and district attorneys for prosecution. For 2001-02, the Administration proposes to reduce funding for local law enforcement technology grants but to provide $232.6 million for the COPS and county juvenile justice crime prevention programs. This is intended to provide for a continuum of response to juvenile crime and delinquency and a swift, certain, and graduated response to juvenile offenders. The Budget also provides $154 million for deferred maintenance of local streets and roads, $60 million in assistance for housing, $209 million for mental health and social services and $34 million for environmental protection. In addition, legislation was enacted in 1999 to provide annual relief to cities based on 1997-98 costs of jail booking and processing fees paid to counties. For 2001-02, cities will receive approximately $38 million in booking fees.

Prior to legislation enacted in 1997, local governments provided the majority of funding for the State's trial court system. The legislation consolidated the trial court funding at the State level in order to streamline the operation of the courts, provide a dedicated revenue source, and relieve fiscal pressure on the counties. This resulted in decreasing the county contribution for court operations by $415 million and allowed cities to retain $68 million in fine and penalty revenue previously remitted to the State. In the 2001-02 fiscal year, the State's trial court system will receive approximately $1.7 billion in State resources and $475 million in resources from the counties.

The entire statewide welfare system has been changed in response to the change in federal welfare law enacted in 1996 (see "Welfare Reform" above). Under the CalWORKs program, counties are given flexibility to develop their own plans, consistent with State law, to implement the program and to administer many of its elements, and their costs for administrative and supportive services are capped at the 1996-97 levels. As noted above, counties are also given financial incentives if, at the individual county level or statewide, the CalWORKs program produces savings associated with specified standards. Counties will still be required to provide "general assistance" aid to certain persons who cannot obtain welfare from other programs.

State Appropriations Limit

The State is subject to an annual appropriations limit imposed by Article XIII B of the State Constitution (the "Appropriations Limit"). The Appropriations Limit does not restrict appropriations to pay debt service on voter-authorized bonds.

Article XIII B prohibits the State from spending "appropriations subject to limitation" in excess of the Appropriations Limit. "Appropriations subject to limitation," with respect to the State, are authorizations to spend "proceeds of taxes," which consist of tax revenues, and certain other funds, including proceeds from regulatory licenses, user charges or other fees to the extent that such proceeds exceed "the cost reasonably borne by that entity in providing the regulation, product or service," but "proceeds of taxes" exclude most State subventions to local governments, tax refunds and some benefit payments such as unemployment insurance. No limit is imposed on appropriations of funds which are not "proceeds of taxes," such as reasonable user charges or fees and certain other non-tax funds.

There are various types of appropriations excluded from the Appropriations Limit. For example, debt service costs of bonds existing or authorized by January 1, 1979, or subsequently authorized by the voters, appropriations required to comply with mandates of courts or the federal government, appropriations for qualified capital outlay projects, appropriations for tax refunds, appropriations of revenues derived from any increase in gasoline taxes and motor vehicle weight fees above January 1, 1990 levels, and appropriation of certain special taxes imposed by initiative (e.g., cigarette and tobacco taxes) are all excluded. The Appropriations Limit may also be exceeded in cases of emergency.

The Appropriations Limit in each year is based on the Limit for the prior year, adjusted annually for changes in State per capita personal income and changes in population, and adjusted, when applicable, for any transfer of financial responsibility of providing services to or from another unit of government or any transfer of the financial source for the provisions of services from tax proceeds to non-tax proceeds. The measurement of change in population is a blended average of statewide overall population growth, and change in attendance at local school and community college ("K-14") districts. The Appropriations Limit is tested over consecutive two-year periods. Any excess of the aggregate "proceeds of taxes" received over such two-year period above the combined Appropriations Limits for those two years, is divided equally between transfers to K-14 districts and refunds to taxpayers.

The Legislature has enacted legislation to implement Article XIII B which defines certain terms used in Article XIII B and sets forth the methods for determining the Appropriations Limit. California Government Code Section 7912 requires an estimate of the Appropriations Limit to be included in the Governor's Budget, and thereafter to be subject to the budget process and established in the Budget Act.

The following table shows the Appropriations Limit for 1997-98 through 2001-02. Because of the extraordinary surge of revenues in 1999-00, the State exceeded its Appropriations Limit by $975 million in that year. As of the enactment of the 2001 Budget Act, the Department of Finance projects the Appropriations Subject to Limit to be $2.089 billion and $9.819 billion under the Appropriations Limit in fiscal years 2000-01 and 2001-02, respectively.

Since the excess revenues are calculated over a two-year period, there are no excess revenues for the combined 1999-00 and 2000-01 fiscal years.

State Appropriations Limit
(Millions)

	Fiscal Years				
	1997-98	1998-99	1999-00	2000-01	2001-02
State Appropriations Limit	$44,778	$47,573	$50,673	$54,073	$59,318
Appropriations Subject to Limit	(40,743)	(43,777)	(51,648)	(51,984)*	(49,499)*
Amount (Over)/Under Limit	$ 4,035	$ 3,796	$ (975)	$ 2,089*	$ 9,819*

*Estimated/Projected
SOURCE: State of California, Department of Finance.

Proposition 98

On November 8, 1988, voters of the State approved Proposition 98, a combined initiative constitutional amendment and statute called the "Classroom Instructional Improvement and Accountability Act." Proposition 98 changed State funding of public education below the university level and the operation of the State Appropriations Limit, primarily by guaranteeing K-14 schools a minimum share of General Fund revenues. Proposition 98 (as modified by Proposition 111, enacted on June 5, 1990) guarantees K-14 schools the greater of (a) in general, a fixed percent of General Fund revenues ("Test 1"), (b) the amount appropriated to K-14 schools in the prior year, adjusted for changes in the cost of living (measured as in Article XIII B by reference to State per capita personal income) and enrollment ("Test 2"), or (c) a third test, which replaces Test 2 in any year the percentage growth in per capita General Fund revenues from the prior year plus one half of one percent is less than the percentage growth in State per capita personal income ("Test 3"). Under Test 3, schools receive the amount appropriated in the prior year adjusted for changes in enrollment and per capita General Fund revenues, plus an additional small adjustment factor. If Test 3 is used in any year, the difference between Test 3 and Test 2 becomes a "credit" to schools and the basis of payments in future years when per capita General Fund revenue growth exceeds per capita personal income growth. Proposition 98 implementing legislation adopted prior to the end of the 1988-89 fiscal year determined the K-14 schools' funding guarantee under Test 1 to be 40.3 percent of the General Fund tax revenues, based on 1986-87 appropriations. However, that percent has been adjusted to approximately 35 percent to account for a subsequent redirection of local property taxes, since such redirection directly affects the share of General Fund revenues to schools.

Proposition 98 permits the Legislature, by two-thirds vote of both houses with the Governor's concurrence, to suspend the K-14 schools' minimum funding formula for a one-year period. Proposition 98 also contains provisions for the transfer of certain State tax revenues in excess of the Article XIII B limit to K-14 schools (see "State Finances--State Appropriations Limit" above).

During the recession in the early 1990s, General Fund revenues were less than originally projected for several years, so that the original Proposition 98 appropriations were higher than the minimum percentage provided in the law. The Legislature designated the "extra" Proposition

98 payments in one year as a "loan" from future years' Proposition 98 entitlements with the intention that "extra" payments would not be included in the Proposition 98 "base" for calculating future years' entitlements. As a result, per-pupil Proposition 98 funding remained approximately $4,200 between fiscal years 1991-92 and 1993-94.

In 1992, a lawsuit titled *California Teachers' Association v. Gould* was filed, challenging the validity of these off-budget loans. A settlement of the lawsuit in 1996 requires both the State and K-14 schools to share in the repayment of $1.76 billion prior years' emergency loans to schools. The State is repaying $935 million by forgiveness, while schools will repay $825 million. The State's share of the repayment is reflected as an appropriation above the current Proposition 98 base calculation. The schools' share of the repayment is reflected as part of the appropriations and counts toward satisfying the Proposition 98 guarantee or from "below" the current base. Repayments are spread over the eight-year period of 1994-95 through 2001-02 to mitigate any adverse fiscal impact.

Substantially increased General Fund revenues in the fiscal years 1994-95 through 2000-01 have resulted in significant increases in the level of Proposition 98 appropriations budgeted for those years. Because of the State's increasing revenues, per-pupil funding at the K-12 level has grown by more than 58 percent since 1991-92, to an estimated $6,678 per pupil in 2000-01. Since the release of the Governor's Budget in January 2001, the projected level of revenue available to the State for fiscal year 2001-02 has declined precipitously. The revenue projection for 2001-02 at the 2001 Budget Act indicates a decline of approximately $4.3 billion. This drop in revenue has changed the calculation of the General Fund share of the minimum K-14 funding level from approximately $30.9 billion to approximately $27.9 billion. However, despite this decline in the calculated minimum guarantee, the 2001 Budget Act funds K-14 education at more than $3.9 billion above the minimum level and less than three percent under the level proposed in the Governor's Budget released in January 2001. Total funding for K-14, including prior year adjustments due to census changes, yields a funding level of more than $45.4 billion (or $7,002 per pupil at the K-12 level) —an increase of nearly six percent in just the last year. The Budget funds new initiatives to improve achievement in low performing schools, advance technology in high schools, enhance school accountability, provide increased professional development in reading and mathematics and expand principal training. See "Current State Budgets" for further discussion of education funding.

Sources of Tax Revenue

The following is a summary of the State's major revenue sources. Further information on State revenues is contained under "Current State Budgets" and "State Finances -- Recent Tax Receipts" below.

Personal Income Tax

The California personal income tax, which in 1999-00 contributed about 55 percent of General Fund revenues and transfers, is closely modeled after the federal income tax law. It is imposed on net taxable income (gross income less exclusions and deductions). The tax is progressive with rates ranging from 1.0 percent to 9.3 percent. Personal, dependent and other credits are allowed against the gross tax liability. In addition, taxpayers may be subject to an alternative minimum tax (AMT), which is much like the federal AMT.

Taxes on capital gains realizations and stock options, which are largely linked to stock market performance, have become a larger component of personal income taxes in the last few years. For the 2000-01 fiscal year, these two income sources appear to have contributed approximately 23 percent of all General Fund tax revenue, a dramatic increase from their 5.6 percent share in 1995-96. The increasing influence that these stock market-related income sources have had on personal income tax revenues over the past few years has added a significant dimension of volatility to this revenue source. For instance, these sources are projected to decline to approximately 17 percent of general fund tax revenues in the 2001-02 fiscal year. See "Current State Budgets – Revenue and Expenditure Assumptions" below.

The personal income tax is adjusted annually by the change in the consumer price index to prevent taxpayers from being pushed into higher tax brackets without a real increase in income.

Sales Tax

The sales tax is imposed upon retailers for the privilege of selling tangible personal property in California. Sales tax accounted for about 29 percent of General Fund revenue and transfers in 1999-00. Most retail sales and leases are subject to the tax. However, exemptions have been provided for certain essentials such as food for home consumption, prescription drugs, gas delivered through mains and electricity. Other exemptions provide relief for a variety of sales ranging from custom computer software to aircraft. Pursuant to federal law, out-of-state sales to Californians over the Internet are not taxed by the State at this time.

The breakdown of the basic 7.00 percent rate imposed on a statewide basis in 2001 is:

- 4.75 percent represents the State General Fund tax rate (expected to increase back to 5.00 percent effective January 1, 2002, due to the sales tax trigger described below).
- 2.00 percent is dedicated to cities and counties.
- 0.25 percent is dedicated to county transit systems.

Legislation in July 1991 raised the sales tax rate by 1.25 percent to its current level. Of this amount, 0.25 percent was added to the General Fund tax rate, and the balance was dedicated to cities and counties. One-half percent was a permanent addition to counties, but with the money earmarked to trust funds to pay for health and welfare programs whose administration was transferred to counties. Another 0.5 percent of the State General Fund tax rate that was scheduled to terminate after June 30, 1993, was extended until December 31, 1993, and allocated to local agencies for public safety programs. Voters in a special election on November 2, 1993, approved a constitutional amendment to permanently extend this 0.5 percent sales tax for local public safety programs.

Pursuant to prior law, 0.25 percent of a basic 5.00 percent State tax rate could be terminated upon certification by the Director of Finance by November 1 in any year that the balance in the budget reserve for two consecutive years exceeded 4 percent of General Fund revenues. The 0.25 percent rate would be reinstated if the Director of Finance subsequently determined that the reserve would not exceed 4 percent of General Fund revenues. Pursuant to this law, a 0.25 percent cut in the State sales tax occurred on January 1, 2001.

Legislation enacted as part of the 2001-02 Budget revised this test to provide that 0.25 percent of the basic 5.00 percent State tax rate may be suspended in any calendar year beginning on and after January 1, 2002, upon certification by the Director of Finance by November 1 in any year in which both of the following occur: (1) the General Fund reserve is expected to exceed 3 percent of revenues in that fiscal year and (2) actual revenues for the period May 1 through September 30 equal or exceed the May Revision forecast. The 0.25 percent rate will be reinstated the following year if the Director of Finance subsequently determines conditions (1) and (2) above are not met for that fiscal year. The Administration projects that the 0.25 percent rate reduction that began January 1, 2001, will be reinstated as of January 1, 2002, based on an estimated budget reserve at June 30, 2002, of less than 3 percent of General Fund revenues. See "Current State Budgets-Fiscal Year 2001-02 Budget" below.

Bank and Corporation Tax

Bank and corporation tax revenues, which comprised about 9 percent of General Fund revenues and transfers in 1999-00, are derived from the following taxes:

1. The franchise tax and the corporate income tax are levied at an 8.84 percent rate on profits. The former is imposed on corporations for the privilege of doing business in California, while the latter is imposed on corporations that derive income from California sources but are not sufficiently present to be classified as doing business in the State.

2. Banks and other financial corporations are subject to the franchise tax plus an additional tax at the rate of 2 percent on their net income. This additional tax is in lieu of personal property taxes and business license taxes.

3. The alternative minimum tax (AMT) is similar to that in federal law. In general, the AMT is based on a higher level of net income computed by adding back certain tax preferences. This tax is imposed at a rate of 6.65 percent.

4. A minimum franchise tax of up to $800 is imposed on corporations subject to the franchise tax but not on those subject to the corporate income tax. New corporations are exempted from the minimum franchise tax for the first two years of incorporation.

5. Sub-Chapter S corporations are taxed at 1.5 percent of profits.

Insurance Tax

The majority of insurance written in California is subject to a 2.35 percent gross premium tax. For insurers, this premium tax takes the place of all other state and local taxes except those on real property and motor vehicles. Exceptions to the 2.35 percent rate are certain pension and profit-sharing plans which are taxed at the lesser rate of 0.5 percent, surplus lines and nonadmitted insurance at 3 percent and ocean marine insurers at 5 percent of underwriting profits. Insurance taxes comprised approximately 2 percent of General Fund revenues and transfers in 1999-00.

Other Taxes

Other General Fund major taxes and licenses include: Estate, Inheritance and Gift Taxes, Cigarette Taxes, Alcoholic Beverage Taxes, Horse Racing Revenues and trailer coach license fees. These other sources totaled approximately 2.0 percent of General Fund revenues and transfers in fiscal year 1999-00.

The California estate tax is based on the state death tax credit allowed against the federal estate tax. The California estate tax is designed to pick up the maximum credit allowed against the federal estate tax return. Along with the recent federal repeal of the estate tax came the phase-out of the State pick-up tax by 2005. The State pick-up tax will be reduced as follows:

- In 2002 the pick-up tax will be reduced by 25 percent from present law amounts.
- In 2003 the pick-up tax will be reduced by 50 percent from present law amounts.
- In 2004 the pick-up tax will be reduced by 75 percent from present law amounts.

Special Fund Revenues

The California Constitution and statutes specify the uses of certain revenue. Such receipts are accounted for in various special funds. In general, special fund revenues comprise three categories of income:

1. Receipts from tax levies which are allocated to specified functions, such as motor vehicle taxes and fees and certain taxes on tobacco products.

2. Charges for special services to specific functions, including such items as business and professional license fees.

3. Rental royalties and other receipts designated for particular purposes (e.g., oil and gas royalties).

Motor vehicle related taxes and fees accounted for about 53 percent of all special fund revenues and transfers in 1999-00. Principal sources of this income are motor vehicle fuel taxes, registration and weight fees and vehicle license fees. During fiscal year 1999-00, $8.3 billion was derived from the ownership or operation of motor vehicles. This was 3.7 percent below the 1998-99 level, due to tax reductions enacted for vehicle license fees. About $4.4 billion of this revenue was returned to local governments. The remainder was available for various State programs related to transportation and services to vehicle owners. These amounts (as well as those shown below in the table "Comparative Yield of State Taxes--All Funds") include the additional fees and taxes derived from the passage of Proposition 111 in June 1990.

Vehicle License Fee

Vehicle license fees, over and above the costs of collection and refunds authorized by law, are constitutionally defined local revenues. Chapter 322, Statutes of 1998 ("Chapter 322"), established a vehicle license fee offset program, scheduled to be implemented in successive stages if General Fund revenues met certain targets. Pursuant to Chapter 322, vehicle license fees were reduced (offset) by 25 percent beginning January 1, 1999. Later legislation increased the offset to 35 percent for 2000 and the first half of calendar year 2001. Beginning July 1, 2001, the offset will be permanently increased to 67.5 percent. These offset levels are expected to reduce vehicle license fee revenues by $1.763 billion in fiscal year 2000-01, $3.554 billion in 2001-02, and $3.855 billion in 2002-03. The amount will be adjusted thereafter as vehicle sales activity changes.

Under Chapter 322, a continuous appropriation from the General Fund backfills the vehicle license fee revenue that local governments would otherwise lose due to the fee reductions. If in any year the Legislature fails to appropriate enough funds to fully backfill the then-applicable vehicle license fee offset, the percentage offset will be reduced to assure that local governments are not disadvantaged.

In response to revenue growth, the Legislature provided an additional 32.5 percent vehicle license fee reduction for the period January 1, 2001, through June 30, 2001. This additional reduction is returned to taxpayers in the form of a rebate. The Legislature appropriated $2.052 billion in 2000-01 to fund taxpayer rebates in 2000-01 and a portion of the 67.5 percent offset in 2001-02. Therefore, total tax relief from the vehicle license fee offset and rebates is $3.8 billion General Fund in fiscal year 2000-01 and $2.3 billion General Fund in 2001-02.

Taxes on Tobacco Products

On November 8, 1988, voters approved Proposition 99, which imposed, as of January 1, 1989, an additional 25 cents per pack excise tax on cigarettes, and a new, equivalent excise tax on other tobacco products. The initiative requires that funds from this tax be allocated to anti-tobacco education and research, to indigent health services, and to environmental and recreation programs.

Proposition 10, approved in 1998, increased the excise tax imposed on distributors selling cigarettes in California to 87 cents per pack effective January 1, 1999. At the same time, this proposition imposed a new excise tax on cigars, chewing tobacco, pipe tobacco, and snuff at a rate equivalent to the tax increase on cigarettes of 50 cents per pack. In addition, the higher excise tax on cigarettes automatically triggered an additional increase in the tax on other tobacco products effective July 1, 1999, with the proceeds going to the Cigarette and Tobacco Products

Surtax Fund. Thus, this Proposition increased the total excise tax on other tobacco products by an amount equivalent to an increase in the cigarette tax of one dollar per pack. There is litigation pending challenging the enactment of these new taxes. See "Litigation."

The State excise tax on cigarettes of 87 cents per pack and other tobacco product taxes are earmarked as follows:

- Fifty cents of the per-pack tax on cigarettes, and the equivalent rate levied on non-cigarette tobacco products, go to the California Children and Families First Trust Fund and are allocated primarily for early childhood development programs.

- Twenty-five cents of the per-pack tax on cigarettes, and the equivalent rates levied on non-cigarette tobacco products are allocated to the Cigarette and Tobacco Products Surtax Fund. These funds are appropriated for anti-tobacco education and research, indigent health services, and environmental and recreation programs. This portion of the excise tax was imposed on January 1, 1989, after voters approved Proposition 99 of 1988.

- Ten cents of the per-pack tax is allocated to the State's General Fund.

- The remaining two cents of the per-pack tax is deposited into the Breast Cancer Fund. Legislation enacted in 1993 added the additional per pack excise tax for the purpose of funding breast cancer research.

Tobacco Litigation

In 1998, the State signed a settlement agreement with the four major cigarette manufacturers. The State agreed to drop its lawsuit and not to sue in the future for monetary damages. Tobacco manufacturers agreed to billions of dollars in payments and restrictions in marketing activities. Under the settlement, the companies agreed to pay California governments approximately \$25 billion (subject to adjustments) over a period of 25 years. Beyond 2025, payments of approximately \$1 billion per year will continue in perpetuity. Under a separate Memorandum of Understanding, half of the money will be paid to the State and half to local governments (all counties and the cities of San Diego, Los Angeles, San Francisco and San Jose). During fiscal year 2000-01, the General Fund received \$383 million in settlement payments. The Budget forecasts payments to the State totaling \$474 million in 2001-02, of which \$72 million will go to the General Fund and the balance will be deposited in a special fund to pay certain healthcare costs.

The specific amount to be received by the State and local governments is subject to adjustment. Details in the settlement allow reduction of the companies' payments for decreases in cigarette sales and certain types of federal legislation. Settlement payments can increase due to inflation or increases in cigarette sales. The "second annual" payment, received in April 2001, was 7.2 percent lower than the base settlement amount due to reduced sales. Future payment estimates have been reduced by a similar percentage. If any of the companies goes into bankruptcy, the State could seek to terminate the agreement with respect to those companies filing bankruptcy actions thereby reinstating all claims against those companies. The State may then pursue those claims in the bankruptcy litigation, or as otherwise provided by law. Also, several parties have brought a lawsuit challenging the settlement and seeking damages; see "Litigation" below.

Recent Tax Receipts

The following table shows the trend of major General Fund and total taxes per capita and per $100 of personal income for the past four years and the current fiscal year.

Trend of State Taxes

	Taxes per Capita(a)		Taxes per $100 of Personal Income	
Fiscal Year	**General Fund**	**Total**	**General Fund**	**Total**
1997-98	$1,632.83	$1,965.33	$6.25	$7.52
1998-99	1,743.16	2,088.35	6.30	7.54
1999-00(b)	2,063.62	2,408.38	7.06	8.24
2000-01(c)	2,201.71	2,565.05	6.87	8.00
2001-02(c)	2,071.82	2,372.97	6.46	7.39

(a) Data reflect population figures based on the 2000 Census and incorporated estimated census undercount.
(b) Preliminary.
(c) Estimated. This estimate will be updated when the Governor's 2002-03 Budget is released on January 10, 2002. See "Recent Developments Regarding State Finances."
SOURCE: State of California, Department of Finance.

The following table gives the actual and estimated revenues by major source for the last four years and the current fiscal year.

COMPARATIVE YIELD OF STATE TAXESóALL F UNDS
1997-98 THROUGH 2001-02
(Modified Accrual Basis)
(Thousands of Dollars)

Year Ending June 30	Sales and Use(a)	Personal Income	Bank and Corporation (b)	Tobacco(c)	Inheritance, Estate and Gift	Insurance	Alcoholic Beverages	Horse Racing	Motor Vehicle Fuel(d)	Motor Vehicle Fees(e)
1998	21,331,691	27,927,940	5,836,881	644,297	780,197	1,221,285	270,947	81,930	2,853,846	5,660,574
1999	22,890,693	30,894,865	5,724,237	976,512	890,490	1,253,972	273,112	61,185	3,025,226	5,610,374
2000	25,525,788	39,578,237	6,638,898	1,216,651	928,146	1,299,777	282,166	44,130	3,069,694	5,263,245
2001(f)	24,581,823(g)	44,760,000	6,583,000	1,159,400	1,115,000	1,470,000	288,000	42,078	3,141,973	5,301,341
2002(f)	24,568,547(g)	42,143,500	5,938,300	1,139,480	922,000	1,452,000	291,000	42,078	3,178,026	3,748,638

(a) For fiscal years 1997-98 through 1999-00, numbers include local tax revenue from the 0.5 percent rate increase that the voters passed in November 1993, for local public safety services. For fiscal years 2000-01 and 2001-02 the estimates do not include this revenue. The 0.5% rate is equivalent to about $2 billion.

(b) Includes the corporation income tax.

(c) Proposition 10 (November 1998) increased the cigarette tax to $0.87 per pack and added the equivalent of $1.00 tax to other tobacco products.

(d) Motor vehicle fuel tax (gasoline), use fuel tax (diesel and other fuels), and jet fuel.

(e) Registration and weight fees, motor vehicle license fees and other fees. Due to the offset program, 1998-99 vehicle license fee values reflect a 25 percent reduction for 1999. The values reflect a 35 percent reduction for 2000 and the first half of 2001. Starting July 1, 2001, values reflect a 67.5 percent reduction.

(f) Estimated. This estimate will be updated when the Governor's 2002-03 Budget is released on January 10, 2002. See "Recent Developments Regarding State Finances."

(g) As stated in footnote (a), the figures for fiscal years 2000-01 through 2001-02 do not include voter approved local revenue.

SOURCE: Fiscal years 1997-98 through 1999-2000: State of California, Office of the State Controller.
Fiscal years 2000-01 and 2001-02: State of California, Department of Finance.

State Expenditures

The following table summarizes the major categories of State expenditures, including both General Fund and special fund programs.

GOVERNMENTAL COST FUNDS
(Budgetary Basis)
Schedule of Expenditures by Function and Character
Fiscal Years 1995-96 to 1999-00
(Thousands)

	1995-96	1996-97	1997-98	1998-99	1999-00
Function					
Legislative, Judicial, Executive					
Legislative	$ 187,768	$ 196,642	$ 209,690	$ 219,814	$ 323,323
Judicial	704,112	716,712	766,932	1,346,131	1,372,681
Executive	691,264	961,025	919,606	958,189	1,241,219
State and Consumer Services	749,368	734,238	771,444	829,745	856,096
Business, Transportation and Housing					
Business and Housing	243,185	115,089	136,558	136,893	156,499
Transportation	3,334,648	3,650,506	3,924,428	4,462,905	5,549,520
Trade and Commerce	51,280	63,789	62,235	130,796	488,489
Resources	1,179,481	1,310,074	1,323,860	1,695,323	1,858,844
Environmental Protection	505,206	507,156	605,584	600,060	689,678
Health and Welfare	17,275,117	17,987,919	18,059,611	19,616,132	21,806,291
Correctional Programs	3,638,672	3,606,674	3,901,296	4,181,474	4,412,542
Education					
Education–K through 12	16,773,927	19,916,015	21,574,341	22,783,975	26,356,838
Higher Education	5,844,282	6,599,573	7,022,658	7,838,117	8,553,343
General Government					
General Administration	672,935	743,024	764,615	859,703	982,923
Debt Service	2,153,682	2,048,475	1,979,211	1,988,176	2,072,960
Tax Relief	474,179	454,509	453,030	450,213	1,840,129
Shared Revenues	3,346,240	3,690,512	3,892,036	4,151,197	3,677,687
Other Statewide Expenditures	202,158	133,309	1,373,823	891,070	580,307
Expenditure Adjustment for Encumbrances	(7,691)	(190,609)	(162,630)	(461,310)	(628,506)
Credits for Overhead Services by General Fund	(130,016)	(147,019)	(125,678)	(144,041)	(170,594)
Statewide Indirect Cost Recoveries	(48,730)	(23,307)	(48,963)	(32,791)	(37,423)
Total	$57,841,067	$63,074,306	$67,403,687	$72,501,771	$81,891,846
Character					
State Operations	$17,341,247	$17,924,850	$20,199,031	$21,092,849	$22,864,874
Local Assistance	39,973,320	44,686,447	46,666,925	50,734,442	58,369,828
Capital Outlay	526,500	463,009	537,731	674,480	657,144
Total	$57,841,067	$63,074,306	$67,403,687	$72,501,771	$81,891,846

SOURCE: State of California, Office of the State Controller.

PRIOR FISCAL YEARSí FINANCIAL RESULTS

Following a severe recession beginning in 1990, the State's financial condition improved markedly during the fiscal years starting in 1995-96, due to a combination of better than expected revenues, slowdown in growth of social welfare programs, and continued spending restraint based on actions taken in earlier years. The State's cash position also improved, and no external deficit borrowing occurred over the end of the last five fiscal years.

The economy grew strongly during the fiscal years beginning in 1995-96, and as a result, the General Fund took in substantially greater tax revenues (around $2.2 billion in 1995-96, $1.6 billion in 1996-97, $2.4 billion in 1997-98, $1.7 billion in 1998-99, and $8.2 billion in 1999-2000) than were initially planned when the budgets were enacted. These additional funds were largely directed to school spending as mandated by Proposition 98, to make up shortfalls from reduced federal health and welfare aid in 1995-96 and 1996-97 and to fund new program initiatives, including education spending above Proposition 98 minimums, tax reductions, aid to local governments and infrastructure expenditures.

The 2000 Budget Act, signed by the Governor on June 30, 2000, assumed General Fund revenues and transfers of $73.9 billion, a 3.8 percent increase over 1999-00 estimates. The 2000 Budget Act appropriated $78.8 billion from the General Fund, a 17.3 percent increase over 1999-00 and reflected the use of $5.5 billion from the Special Fund for Economic Uncertainties available from surpluses in the prior year. In order not to place undue pressure on future budget years, about $7.0 billion of the increased spending in 2000-01 was for one-time expenditures and investments. Because of the State's strong cash position, the Administration announced that it would not undertake a revenue anticipation note borrowing in 2000-01.

The extraordinary fiscal resources available in 2000-01 allowed the State to provide significantly increased funding for K-12 schools, higher education and health and human services.

New funding was also provided on a one-time basis to local governments. Significant moneys were devoted for capital outlay. A total of $2.0 billion of General Fund money was appropriated for transportation improvements, supplementing gasoline tax revenues normally used for that purpose. This was part of a $6.9 billion Transportation Congestion Relief Program to be implemented over six years. In addition, the Budget Act included $570 million from the General Fund in new funding for housing programs.

A total of about $1.5 billion of tax relief was enacted as part of the budget process. The vehicle license fee reduction, started in 1998, was accelerated to the final 67.5 percent level for calendar year 2001, two years ahead of schedule. The acceleration will cost the General Fund about $887 million in fiscal year 2000-01 and $1.426 billion in fiscal year 2001-02. A one-time Senior Citizens Homeowner and Renters Tax Assistance program will cost about $154 million. A personal income tax credit for teachers will cost $218 million and a refundable credit for child care expenses will cost $195 million. Several other targeted tax cuts, primarily for businesses, were also approved, at a cost of $89 million in 2000-01.

The 2001-02 Governor's Budget released on January 10, 2001, provided revised 2000-01 revenue and expenditure estimates. These estimates were further updated on May 14, 2001, with the release of the May Revision to the Governor's Budget (the "May Revision") and at the time of adoption of the 2001 Budget Act in July, 2001. This estimate will be updated when the Governor's 2002-03 Budget is released on January 10, 2002. See "Recent Developments Regarding State Finances." Expenditures in 2000-01 were estimated to be $80.1 billion, about $1.3 billion above the Budget Act estimates. The Department of Finance estimated in the 2001 Budget Act that the June 30, 2001 SFEU balance, the budget reserve, would be approximately $6.3 billion, a substantial increase over the 2000 Budget Act estimate of $1.78 billion. This reserve has been virtually entirely used to provide advances to support the Department of Water Resources power purchase program (see "Recent Development Regarding Energy" above) without the need for the General Fund to seek internal or external borrowing for that purpose.

CURRENT STATE BUDGETS

The discussion below of the fiscal year 2001-02 budget and the table under "Summary of State Revenues and Expenditures" are based on estimates and projections of revenues and expenditures for the current fiscal year and must not be construed as statements of fact. These estimates and projections are based upon various assumptions as updated in the 2001 Budget Act, which may be affected by numerous factors, including future economic conditions in the State and the nation, and there can be no assurance that the estimates will be achieved. See "Recent Developments Regarding State Finances" above and "Current State Budgets– Revenue and Expenditure Assumptions" below.

Fiscal Year 2001-02 Budget

Background. The 2001-02 Governor's Budget, released January 10, 2001, estimated 2001-02 General Fund revenues and transfers to be about $79.4 billion and proposed $82.9 billion in expenditures, utilizing a portion of the surplus expected from 2000-01. The Governor proposed budget reserves in 2001-02 of $2.4 billion, including $500 million for unplanned litigation costs.

The May Revision disclosed a reversal of the recent General Fund financial trend, as a result of the slowdown in economic growth in the State starting in the first quarter of 2001 and, most particularly, the steep drop in stock market levels since early 2000. See "Revenue and Expenditure Assumptions" below. The 2001 Budget Act projects General Fund revenues in 2001-02 will be about $75.1 billion, a drop of $2.9 billion from revised 2000-01 estimates and $4.3 billion below the estimate in the 2001-02 Governor's Budget. Most of the drop is attributed to the personal income tax, which reflects both slower job and wage growth and a severe decline in capital gains and stock option income, which is included in personal income tax statistics. Lower corporate earnings are projected to result in a drop in the corporate income tax, while sales taxes are projected to increase slightly.

Fiscal Year 2001 Budget Act. The Fiscal Year 2001 Budget Act was signed by the Governor on July 26, 2001, almost four weeks after the start of the fiscal year. The Governor vetoed almost $500 million General Fund expenditures from the Budget passed by the

Legislature. The spending plan for 2001-02 included General Fund expenditures of $78.8 billion, a reduction of $1.3 billion from the prior year. This could be accomplished without serious program cuts because such a large part of the 2000 Budget Act comprised one-time expenditures. The spending plan utilized more than half of the budget surplus as of June 30, 2001, but still left a projected balance in the SFEU at June 30, 2002 of $2.6 billion, the largest appropriated reserve in State history. The 2001 Budget Act assumed that, during the course of the fiscal year, the $6.1 billion advanced by the General Fund to the Department of Water Resources for power purchases will be repaid with interest. See "Recent Developments Regarding Energy" above.

The 2001 Budget Act also included Special Fund expenditures of $21.3 billion and Bond Fund expenditures of $3.2 billion. The State issued $5.7 billion of revenue anticipation notes on October 4, 2001 as part of its cash management program. See "State Indebtedness – Cash Flow Borrowing" above. An updated estimate of fiscal year 2001-02 revenues and expenditures will be included in the Governor's 2002-03 Budget, to be released on January 10, 2002. See "Recent Developments Regarding State Finances."

Some of the important features of the 2001 Budget Act were the following:

1. Proposition 98 per pupil spending was increased by 4.9 percent to $7,002. Total General Fund spending of $32.4 billion for K-12 education fully funds enrollment and cost of living increases and also provides additional funding for a number of programs, such as teacher and principal training programs, instructional and student achievement improvement programs, energy cost assistance, and high-tech high schools.

2. Higher education funding was increased to allow for enrollment increases at both the University of California and the California State University system with no fee increases. Additional funding was also provided for 3 percent student growth at community colleges.

3. Health, welfare and social services generally were fully funded for anticipated caseload growth. The 2001 Budget Act adopted an Administration proposal to utilize $402 million of tobacco litigation settlement payments to fund certain health programs.

4. In addition to $4.3 billion of continuing tax relief, the 2001 Budget Act contained about $125 million in new General Fund tax relief, primarily for senior citizens property tax assistance and certain new tax credits aimed at rural areas and agricultural equipment. As noted above, the Legislature modified the law permitting a 0.25 percent cut in the state sales tax rate if the General Fund reserve exceeds three percent of revenues in the current fiscal year. This change was not expected to impact the 2001-02 fiscal year.

5. The 2001 Budget Act altered the six-year transportation funding plan started in the 2000-01 fiscal year. The Legislature postponed for two years the transfer of sales taxes on gasoline to support transportation programs, and this transfer will take place during the 2003-04 to 2007-08 fiscal years. As a result, $2.5 billion of these sales tax revenues will remain in the General Fund over the 2001-02 and 2002-03 fiscal years. To allow all current projects to remain on schedule through 2002-03, the legislation authorized certain internal loans from other

transportation accounts. Part of the Budget Act compromise was an agreement to place on the March 2002 statewide ballot a constitutional amendment which would make permanent, after 2007-08, the dedication of sales taxes on gasoline to transportation purposes.

6. The 2001 Budget Act provided significant assistance to local governments including $232.6 million for the COPS and county juvenile justice crime prevention programs, $209 million for mental health and social services, $154 million for street and road maintenance, $124 million for various public safety programs and $34 million for environmental protection.

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Summary of State Revenues and Expenditures

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCEñGENERAL FUND (Budgetary Basis)(a) FISCAL YEARS 1997-98 THROUGH 2001-02 (Millions)

				Estimated[b]	
	1997-98	1998-99	1999-00	2000-01[c]	2001-02[c]
Fund BalanceñBeginning of Period	$ 639.8	$ 2,792.5	$ 3,907.7	$ 9,639.7	$ 7,055.3
Restatements					
Prior Year Revenue, Transfer Accrual Adjustments	(165.3)	(147.1)	(204.6)	(0.8)	--
Prior Year Expenditure, Accrual Adjustments	498.1	162.3	217.1	(499.9)	--
Fund BalanceñBeginning of Period, as Restated	$ 972.6	$ 2,807.7	$ 3,920.2	$9,139.0	$ 7,055.3
Revenues	$54,797.7	$58,935.1	$71,555.6	$77,961.3	$74,072.7
Other Financing Sources					
Transfers from Other Funds	132.0	93.9	423.3	41.8	1,032.5
Other Additions	154.4	339.4	48.1	--	--
Total Revenues and Other Sources	$55,084.1	$59,368.4	$72,027.0	$78,003.1	$75,105.2
Expenditures					
State Operations	$14,042.1	$14,775.8	$15,942.8	$17,978.1	$18,865.0
Local Assistance	38,990.4	42,260.3	49,974.7	59,686.9	59,599.2
Capital Outlay	57.2	235.7	186.2	2,418.8	299.2
Unclassified				3.0	
Other Uses					
Transfer to Other Funds	174.5	996.6	203.8	--[d]	--[d]
Total Expenditures and Other Uses	$53,264.2	$58,268.4	$66,307.5	$80,086.8	$78,763.4
Revenues and Other Sources Over or (Under) Expenditures and Other Uses --	$ 1,819.9	$ 1,100.0	$ 5,719.5	$ (2,083.7)	$(3,658.2)
Fund Balance					
Reserved for Encumbrances	$ 478.7	$ 592.0	$ 701.3	$ 701.0	$ 701.0
Reserved for Unencumbered Balances of Continuing Appropriations[e]	122.8	697.6	1,115.2	912.5	413.8
Reserved for School Loans[f]	1,259.7	1,009.7	699.7	349.7	--
Unreserved–Undesignated[g]	931.3	1,608.4	7,123.5	5,092.1	2,282.3
Fund BalanceñEnd of Period	$ 2,792.5	$ 3,907.7	$ 9,639.7	$ 7,055.3	$ 3,397.1

Footnotes on following page.

SOURCE: Fiscal years 1997-98 to 1999-00: State of California, Office of the State Controller.
Fiscal years 2000-01 and 2001-02: State of California, Department of Finance.

(a) These statements have been prepared on a budgetary basis in accordance with State law and some modifications would be necessary in order to comply with generally accepted accounting principles ("GAAP"). The audited general purpose financial statements of the State contain a description of the differences between the budgetary basis and the GAAP basis of accounting. See "Financial Statements" below.

(b) Estimates are shown net of reimbursements and abatements. See "Recent Developments Regarding State Finances" above.

(c) Estimated as of the enactment of the 2001 Budget Act on July 26, 2001. This estimate will be updated when the Governor's 2002-03 Budget is released on January 10, 2002. See "Recent Developments Regarding State Finances."

(d) "Transfer to Other Funds" is included either in the expenditure totals detailed above or as "Transfer from Other Funds."

(e) For purposes of determining whether the General Fund budget, in any given fiscal year, is in a surplus or deficit condition, Chapter 1238, Statutes of 1990, amended Government Code Section 13307. As part of the amendment, the unencumbered balances of continuing appropriations which exist when no commitment for an expenditure is made should be an item of disclosure, but the amount shall not be deducted from the fund balance. Accordingly, the General Fund condition included in the 2001-02 Governor's Budget includes the unencumbered balances of continuing appropriations as a footnote to the statement ($1.483 billion in 1999-00, $912.5 million in 2000-01 and $413.8 million in 2001-02). However, in accordance with Government Code Section 12460, the State's Budgetary/Legal Basis Annual Report reflects a specific reserve for the unencumbered balance for continuing appropriations.

(f) During 1995, a reserve was established in the General Fund balance for the $1.7 billion of previously recorded school loans which had been authorized by Chapter 703, Statutes of 1992 and Chapter 66, Statutes of 1993. These loans are to be repaid from future General Fund appropriations. See "State Finances - Proposition 98" above for a discussion of the settlement of the *CTA v. Gould* lawsuit. This accounting treatment is consistent with the State's audited financial statements prepared in accordance with GAAP.

(g) Includes Special Fund For Economic Uncertainties (SFEU). The Department of Finance generally includes in its estimates of the SFEU and set-aside reserves, if any, the items reported in the table under "Reserved for Unencumbered Balances of Continuing Appropriations," "Reserved for School Loans," and "Unreserved-Undesignated." The 2001 Budget Act projects the SFEU to be $6.347 billion on June 30, 2001, and $2.596 billion on June 30, 2002. Additionally, the Budget includes a set-aside for legal contingencies of $7.0 million in 2000-01 and $100.0 million in 2001-02. If not expended, this set-aside will become part of the SFEU.

Revenue and Expenditure Assumptions

See "Recent Developments Regarding State Finances" above.

The table below presents the Department of Finance's budget basis statements of major General Fund revenue sources and expenditures for the 1999-00 fiscal year and the 2001 Budget Act estimates for the 2000-01 and 2001-02 fiscal years. This estimate will be updated when the Governor's 2002-03 Budget is released on January 10, 2002. See "Recent Developments Regarding State Finances."

Revenues (Millions)

	Fiscal Years			
Source	**1999-00[a] Actual**	**2000-01[b] Enacted**	**2000-01[c] Revised**	**2001-02[c] Enacted**
Personal Income Tax	$39,575	$41,339	$44,760	$42,144
Sales and Use Tax	21,137	21,318	21,550	21,949
Bank and Corporation Tax	6,639	6,800	6,583	5,938
Insurance Tax	1,300	1,321	1,470	1,452
All Other	3,280[d]	3,084[e]	3,640[e]	3,622[f]
Total Revenues and Transfers	$71,931	$73,862	$78,003	$75,105

Expenditures (Millions)

	Fiscal Years			
Function	**1999-00[a] Actual**	**2000-01[b] Enacted**	**2000-01[c] Revised**	**2001-02[c] Enacted**
K-12 Education	$27,588	$30,603	$29,950	$32,437
Health and Human Services	17,531	20,284	20,126	21,898
Higher Education	8,021	9,445	9,341	9,901
Youth and Adult Correctional	4,748	5,179	5,179	5,242
Legislative, Judicial and Executive	2,288	2,616	2,670	2,618
Tax Relief	1,842	4,488	4,639	3,020
Resources	1,184	1,599	2,496	1,272
State and Consumer Services	481	533	600	580
Business, Transportation and Housing	394	2,586	2,577	696
All Other	2,417	1,483	2,509	1,099
Total Expenditures	$66,494	$78,816	$80,087	$78,763

(a) Figures for 1999-00, prepared by the Department of Finance, are slightly different than the figures on page A-33, prepared by the State Controller's Office, because of certain differences in accounting methods used by the two offices.
(b) 2000 Budget Act, June 30, 2000.
(c) 2001 Budget Act, July 26, 2001.
(d) Includes $515 million from tobacco litigation settlement payment.
(e) Includes $383 million from tobacco litigation settlement payment.
(f) Includes $72 million from tobacco litigation settlement payment.
SOURCE: State of California, Department of Finance.

The Revenue and Expenditure assumptions set forth have been based upon certain estimates of the performance of the California and national economies in calendar years 2001 and 2002. In the 2001 Budget Act signed on July 26, 2001, the Department of Finance projected that the California economy will continue to grow, but at a more moderate pace. U.S. economic growth was slower than expected in recent months, and the national slowdown began to affect California. Stock prices—especially in the high-technology sector—were lower than projected in January. Additionally, while the energy crisis had not yet directly affected the national or California economy, rising wholesale energy costs were expected to have a ripple effect throughout the western United States. Reflecting these developments, forecasts of most economic indicators were revised down from the 2001-02 Governor's Budget as released in January 2001.

The California economy avoided the national slowdown during the second half of 2000, entering 2001 with very strong momentum. The State accounted for more than two-thirds of all new jobs created in the nation on an April 2000-to-April 2001 comparison. Of particular note, manufacturing employment, down by 553,000 nationwide over the past year, actually posted a 12,000-job gain in California on an April-to-April comparison.

Although California's growth continued to outpace the nation by a wide margin, the State was clearly not immune to a nationwide slowdown in economic activity. The early months of 2001 revealed a significant moderation in the State's economic growth. Gains in nonfarm employment, which averaged more than 150,000 each quarter during 2000, slowed to only 41,500 during the first three months of 2001.

In addition, announcements by several of the State's major companies pointed to a softening in high-tech jobs in the months ahead. However, to an increasing degree, California companies specialize in the advanced stages of design, research, and development, rather than the actual manufacturing of finished goods and components. Because most technology-oriented firms are reluctant to cut future product development, the effects of the weakness in high-technology goods and services are likely to be somewhat muted in California.

Given the recent slowing of job growth, non-farm employment this year is likely to moderate to 2.3 percent growth, down from 3.8 percent in 2000. Even though some pickup is projected in 2002, year-to-year average growth is expected to be under 2 percent. The unemployment rate—a lagging indicator—is forecast to edge up to 5 percent this year from a 4.9 percent average in 2000, and rise further to 5.7 percent in 2002.

Construction trends are expected to be mixed. Low interest rates and a large backlog of unmet demand should encourage further gains in new residential construction, with 160,000 new units authorized by building permits in 2001, up from 150,000 in 2000. Next year, homebuilding is expected to reach 166,000 units.

Although California has avoided the commercial construction excesses of the 1980s, slower job growth, coupled with new supply already under construction, will result in rising commercial and retail vacancy rates, which in turn will discourage new construction starts. After several years of strong double-digit growth, nonresidential permit values (not adjusted for inflation) are expected to slow to 6.4 percent growth this year and 2.6 percent in 2002.

The Stock Market and Personal Income. Much of the extraordinary income growth in 2000 reflected a surge in stock option incomes—counted in wages and salaries—reflecting the "bubble" in the technology-heavy NASDAQ index that more than doubled in value between mid-October 1999 and early March 2000. Of the $81 billion increase in wages and salaries last year, the Department of Finance estimated that $34 billion or 42 percent was attributable to the increase in the value of stock options exercised.

As a result of the collapse of this bubble, the projected slowdown in personal income growth—from a 16-year high of 11.5 percent in 2000, to only 2 percent in 2001—was far greater than warranted by the moderation in job gains from 3.8 percent last year to 2.3 percent in 2001. With the NASDAQ having given up nearly 60 percent from the March 5, 2000 peak as of July 2001, it seems virtually certain that option-generated incomes will fall from last year's elevated levels. Forecasting this increasingly important but extremely volatile element of income involves assumptions both about stock prices over the remainder of 2001 and about the behavior of option holders.

Lower stock prices reduce the value of each option exercised, especially since the strike price (the price at which the option holder actually "buys" the shares) rises over time. In addition, it seems likely that skyrocketing stock prices last year encouraged the exercise of more options than would have occurred under more ordinary circumstances. Thus, some of last year's options were accelerated from 2001 and future years.

The July 2001 forecast assumed that option-related incomes in 2001 would drop back to near 1999 levels, representing a decline of about 37 percent, or $31 billion, from 2000. This assumption allowed for some further recovery in the NASDAQ, which averaged about 2800 in 1999, about 600 points higher than the early May trading range. See "Recent Developments Regarding State Finances" above.

To illustrate the impact of this assumption on personal income, if stock option-related incomes were held constant, 2001 personal income growth in the forecast would be 7.6 percent rather than 2 percent. Because much of this option income is taxed at or near the top 9.3 percent personal income tax rate, the effect on General Fund revenues is even larger than implied by the effect on household incomes.

In addition to options, the stock market also affects personal income tax revenues through capital gains on the sale of stocks and the gains realized within mutual funds. These gains are excluded from the economic measure of personal income.

The Department set out the following estimates for the State's economic performance which were used in predicting revenues and expenditures for the 2001 Budget Act. Also shown was the Department's previous forecast for the calendar years 2001 and 2002, contained in the 2001-02 Governor's Budget.

	For Calendar Year 2001		For Calendar Year 2002	
	Budget Act[(a)]	Governorís Budget[(b)]	Budget Act [(a)]	Governorís Budget[(b)]
Non-farm wage and salary employment (000)	14,864	14,929	15,116	15,333
Percent Change	2.3%	2.8%	1.7%	2.7%
Personal income ($ billions)	$1,128	$1,171	$1,191	$1,253
Percent Change	2.0%	5.7%	5.6%	6.9%
Housing Permits (Units 000)	160	155	166	167
Consumer Price Index (% change)	4.5%	3.1%	2.4%	2.5%

(a) 2001 Budget Act: July 26, 2001.
(b) 2001-02 Governor's Budget: January 10, 2001.
SOURCE: State of California, Department of Finance.

FINANCIAL STATEMENTS

Audited General Purpose Financial Statements of the State of California (the "Financial Statements") are available for the year ended June 30, 2000. Such Financial Statements have been filed with all of the Nationally Recognized Municipal Securities Information Repositories as part of the Official Statement for State General Obligation Bonds sold previously this year, and are incorporated by reference into this Appendix. Potential investors may obtain or review a copy of the Financial Statements from the following sources:

1. By obtaining from any Nationally Recognized Municipal Securities Information Repository, or any other source, a copy of the State of California's Official Statement dated February 27, 2001, relating to the issuance of $600,000,000 of General Obligation Bonds and $354,430,000 General Obligation Refunding Bonds. The Financial Statements are printed in full in such Official Statement. No part of the February 27, 2001 Official Statement *except* the Financial Statements is incorporated into this document.

2. By accessing the Internet Website of the State Controller (www.sco.ca.gov) and clicking on the icons for "Publications;" "State and Local Government Financial Reports;" and "Comprehensive Annual Financial Report –2000" in that order or by contacting the Office of the State Controller at (916) 445-2636.

3. By accessing the Internet Website of the State Treasurer (www.treasurer.ca.gov) and clicking on the icons for "Financial Information" and "Audited General Purpose Financial Statements" in that order, or by contacting the Office of the State Treasurer at (800) 900-3873.

Certain unaudited financial information for the periods July 1, 2000 – June 30, 2001 and July 1, 2001 – October 31, 2001 are also included as Exhibits 1 and 2 to Appendix A.

Periodic reports on revenues and/or expenditures during the fiscal year are issued by the Administration, the State Controller's Office and the Legislative Analyst's Office. The Department of Finance issues a monthly Bulletin which reports the most recent revenue receipts as reported by State departments, comparing them to budget projections. The Administration also formally updates its budget projections three times during each fiscal year, in January, May, and at budget enactment. These bulletins and reports are available on the Internet at websites maintained by the agencies and by contacting the agencies at their offices in Sacramento, California. Such bulletins and reports are not part of or incorporated into this Official Statement. Investors are cautioned that interim financial information is not necessarily indicative of results for a fiscal year. Information which may appear in this Official Statement from the Department of Finance concerning monthly receipts of "agency cash" may differ from the State Controller's reports of cash receipts for the same periods because of timing differences in the recording of in-transit items.

ECONOMY AND POPULATION

Introduction

California's economy, the largest among the 50 states and one of the largest in the world, has major components in high technology, trade, entertainment, agriculture, manufacturing, tourism, construction and services. Since 1994, California's economy has been performing strongly after suffering a deep recession between 1990 and 1993.

Fuel and other energy prices have risen sharply in recent months. The State Department of Finance notes that the State and national economies are much more energy-efficient than during the energy crises of the 1970s and early 1980s, and that, adjusted for inflation, motor fuel prices are still 20 percent below the 1981 level. See "Recent Developments Regarding Energy" above.

Population and Labor Force

The State's July 1, 2000 population of over 34 million represented over 12 percent of the total United States population.

California's population is concentrated in metropolitan areas. As of the April 1, 2000 census, 97 percent resided in the 25 Metropolitan Statistical Areas in the State. As of July 1, 2000, the 5-county Los Angeles area accounted for 48 percent of the State's population, with over 16.0 million residents, and the 10-county San Francisco Bay Area represented 21 percent, with a population of over 7.0 million.

The following table shows California's population data for 1994 through 2000.

Population 1994-00

Year	California Population[a]	% Increase Over Preceding Year	United States Population[a]	% Increase Over Preceding Year	California as % of United States
1994	32,155,000	0.5%	260,327,000	1.0%	12.4%
1995	32,291,000	0.4	262,803,000	1.0	12.3
1996	32,501,000	0.7	265,229,000	0.9	12.3
1997	32,985,000	1.5	267,784,000	1.0	12.3
1998	33,387,000	1.2	270,248,000	0.9	12.4
1999	33,934,000	1.6	272,691,000	0.9	12.4
2000	34,480,000	1.6	275,130,000	0.9	12.5

(a) Population as of July 1.

SOURCE: U. S. figures from U.S. Department of Commerce, Bureau of the Census; California figures from State of California, Department of Finance.

The following table presents civilian labor force data for the resident population, age 16 and over, for the years 1993 to 2000.

Labor Force 1993-00

	Labor Force Trends (Thousands)		Unemployment Rate (%)	
Year	Labor Force	Employment	California	United States
1993	15,360	13,918	9.4%	6.9%
1994	15,450	14,122	8.6	6.1
1995	15,412	14,203	7.8	5.6
1996	15,512	14,392	7.2	5.4
1997	15,947	14,943	6.3	4.9
1998	16,337	15,368	5.9	4.5
1999	16,597	15,732	5.2	4.2
2000	17,091	16,246	4.9	4.0

SOURCE: State of California, Employment Development Department.

Employment, Income, Construction and Export Growth

The following table shows California's non-agricultural employment distribution and growth for 1990 and 2000.

Payroll Employment By Major Sector
1990 and 2000

	Employment (Thousands)		% Distribution of Employment	
Industry Sector	**1990**	**2000**	**1990**	**2000**
Mining	38.9	23.3	0.3%	0.2%
Construction	605.3	733.6	4.8	5.1
Manufacturing				
Nondurable goods	720.6	726.5	5.7	5.0
High Technology	686.0	513.9	5.4	3.5
Other Durable Goods	690.3	703.8	5.5	4.8
Transportation and Utilities	623.9	745.6	4.9	5.1
Wholesale and Retail Trade	3,002.2	3,300.8	23.7	22.7
Finance, Insurance And Real Estate	824.6	823.2	6.5	5.7
Services	3,395.3	4,626.8	26.8	31.9
Government				
Federal	362.1	274.4	2.9	1.9
State and Local	1,712.7	2,046.9	13.5	14.1
TOTAL NONAGRICULTURAL	12,661.9	14,518.8	100%	100%

SOURCE: State of California, Employment Development Department and State of California, Department of Finance.

The following tables show California's total and per capita income patterns for selected years.

Total Personal Income 1993-00[a]

	California		
Year	**Millions**	**% Change[b]**	**California % of U.S.**
1993	$714,107	1.8%	12.8%
1994[c]	735,104	2.9	12.5
1995	771,470	4.9	12.5
1996	812,404	5.3	12.4
1997	861,557	6.1	12.4
1998	931,627	8.1	12.6
1999	997,293	7.0	12.8
2000	1,094,770	9.8	13.2

(a) Personal income for 1997-2000 revised by BEA, September 24, 2001.
(b) Change from prior year.
(c) Reflects Northridge earthquake, which caused an estimated $15 billion drop in personal income.
Note: Omits income for government employees overseas.
SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis (BEA).

Per Capita Personal Income 1993-99[a]

Year	California	% Change[b]	United States	% Change[b]	California % of U.S.
1993	$ 22,927	0.9%	$21,718	3.0%	105.6%
1994[c]	23,473	2.4	22,581	4.0	104.0
1995	24,496	4.4	23,562	4.3	104.0
1996	25,563	4.4	24,651	4.6	103.7
1997	26,759	4.7	25,874	5.0	103.4
1998	28,280	5.7	27,322	5.6	103.5
1999	29,910	5.8	28,542	4.5	104.8

(a) Historical personal income series revised by BEA, released May 17, 2000 & September 12, 2000.
(b) Change from prior year.
(c) Reflects Northridge earthquake, which caused an estimated $15 billion drop in personal income.
Note: Omits income for government employees overseas.

SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis (BEA); State of California, Department of Finance.

The following tables show California's residential and non-residential construction authorized by permits for selected years.

Residential Construction Authorized by Permits

	Units			
Year	Total	Single	Multiple	Valuation [a] (millions)
1995	85,293	68,689	16,604	$13,879
1996	94,283	74,923	19,360	15,289
1997	111,716	84,780	26,936	18,752
1998	125,707	94,298	31,409	21,976
1999	140,137	101,711	38,426	25,783
2000	148,540	105,595	42,945	28,142

(a) Valuation includes additions and alterations.

SOURCE: Construction Industry Research Board

Nonresidential Construction
(Thousands of dollars)

Year	Commercial	Industrial	Other	Additions and Alterations	Total
1995	$2,308,912	$ 732,877	$1,050,684	$4,062,271	$ 8,154,744
1996	2,751,909	1,140,575	1,152,425	4,539,219	9,584,128
1997	4,271,378	1,598,428	1,378,220	5,021,792	12,269,818
1998	5,419,251	2,466,530	1,782,337	5,307,901	14,976,019
1999	5,706,719	2,256,166	2,350,213	6,269,194	16,582,292
2000	6,962,021	2,206,168	2,204,745	7,251,987	18,624,921

SOURCE: Construction Industry Research Board

The following table shows California's export growth for the period from 1995 through 2000.

Exports Through California Ports
(In millions)

Year	Exports [(a)]	% Change
1995	$ 116,825.5	22.2%
1996	124,120.0	6.2
1997	131,142.7	5.7
1998	116,282.4	-11.3
1999	122,092.8	5.0
2000	148,554.6	21.7

(a) "free along ship" Value Basis

SOURCE: U.S. Department of Commerce, Bureau of the Census

LITIGATION

The State is a party to numerous legal proceedings. The following are the most significant pending proceedings, as reported by the Office of the Attorney General. See "Litigation" in the main body of this Official Statement.

On June 24, 1998, plaintiffs in *Howard Jarvis Taxpayers Association et al.* v. *Kathleen Connell* filed a complaint for certain declaratory and injunctive relief challenging the authority of the State Controller to make payments from the State Treasury in the absence of a State budget. On July 21, 1998, the trial court issued a preliminary injunction prohibiting the State Controller from paying moneys from the State Treasury for fiscal year 1998-99, with certain limited exceptions, in the absence of a State budget. The preliminary injunction, among other things, prohibited the State Controller from making any payments pursuant to any continuing appropriation. On July 22 and 27, 1998, various employee unions which had intervened in the case appealed the trial court's preliminary injunction and asked the Court of Appeal to stay the preliminary injunction. On July 28, 1998, the Court of Appeal granted the unions' requests and stayed the preliminary injunction pending the Court of Appeal's decision on the merits of the appeal. On August 5, 1998, the Court of Appeal denied the plaintiffs' request to reconsider the stay. Also on July 22, 1998, the State Controller asked the California Supreme Court to immediately stay the trial court's preliminary injunction and to overrule the order granting the preliminary injunction on the merits. On July 29, 1998, the Supreme Court transferred the State Controller's request to the Court of Appeal. The matters are now pending before the Court of Appeal. Briefs have been submitted; no date has yet been set for oral argument.

In January of 1997, California experienced major flooding with preliminary estimates of property damage of approximately \$1.6 to \$2.0 billion. In *McMahon v. State*, a substantial number of plaintiffs have joined suit against the State, local agencies, and private companies and contractors seeking compensation for the damages they suffered as a result of the 1997 flooding. After various pre-trial proceedings, the State filed its answer to the plaintiffs' complaint in January of 2000. The trial is set for July 2002. The State is vigorously defending the action.

The State is involved in a lawsuit related to contamination at the Stringfellow toxic waste site. In *United States, California* v. *J.B. Stringfellow, Jr., et al.*, the State is seeking recovery for past costs of cleanup of the site, a declaration that the defendants are jointly and severally liable for future costs, and an injunction ordering completion of the cleanup. However, the defendants have filed a counterclaim against the State for alleged negligent acts, resulting in significant findings of liability against the State as owner, operator, and generator of wastes taken to the site. The State has appealed the rulings. Present estimates of the cleanup range from \$400 million to \$600 million. Potential State liability falls within this same range. However, all or a portion of any judgment against the State could be satisfied by recoveries from the State's insurance carriers. The State has filed a suit against certain of these carriers. The trial on the coverage action is not expected to begin until late 2002 at the earliest.

The State is a defendant in *Paterno v. State of California*, a coordinated action involving 3,000 plaintiffs seeking recovery for damages caused by the Yuba River flood of February 1986. The trial court found liability in inverse condemnation and awarded damages of \$500,000 to a sample of plaintiffs. The State's potential liability to the remaining plaintiffs ranges from \$800 million to \$1.5 billion. In 1992, the State and plaintiffs filed appeals. In August 1999, the Court of Appeal issued a decision reversing the trial court's judgment against the State and remanding the case for retrial on the inverse condemnation cause of action. The California Supreme Court denied plaintiffs' petition for review. After a four-month trial and consideration of plaintiff's objections to the court's Intended Decision, the court ruled that plaintiffs take nothing from defendants.

In *County of San Bernardino* v. *State Department of Health Services* and *Barlow Respiratory Hospital v. State Department of Health Services,* which are being tried together in state court, plaintiffs seek mandamus relief requiring the State to retroactively increase out-patient Medi-Cal reimbursement rates. Plaintiffs in *Orthopedic Hospital v. Belshe,* a federal court action, seek the same relief on a prospective basis. Plaintiffs in the state court action have estimated that the retroactive damages could exceed \$500 million. Should prospective relief be granted, the State's costs could increase by more than \$100 million per year in future years. The State is vigorously defending these cases. The trial in the *County of San Bernardino* and *Barlow* cases is scheduled to have three phases: law, fact and remedy phases. The state court litigation has been stayed pending settlement negotiations which have resulted in settlement of all three cases for $350 million in retroactive payments and a 30 percent increase in reimbursement rates beginning July 1, 2001, with 3.33 percent increases in each of the following three years. However, this settlement is subject to approval by the United States Department of Health and Human Services, Health Care Financing Administration and authorization of federal financial participation.

The State is involved in three refund actions, *California Assn. Of Retail Tobacconists (CART), et al.* v. *Board of Equalization, et al., Cigarettes Cheaper!, et al.* v. *Board of Equalization, et al.* and *McLane/Suneast, et al. v. Board of Equalization, et al.*, that challenge the constitutionality of Proposition 10, which the voters passed in 1998 to establish the Children and Families Commission and local county commissions and to fund early childhood development programs. *CART* and *Cigarettes Cheaper!* allege that Proposition 10, which increases the excise tax on tobacco products, violates 11 sections of the California Constitution and related provisions of law. McLane/Suneast challenges only the "double tax" aspect of Proposition 10. Trial of these three consolidated cases commenced on September 15, 2000, and concluded on November 15, 2000. A final statement of decision issued on December 7, 2000, and judgment in favor of all defendants as to all 30 consolidated counts was entered on January 9, 2001. The McLane/Suneast and U.S. Tobacco plaintiffs timely appealed all "double tax" issues, and the CART plaintiffs and Cigarettes Cheaper! plaintiffs timely appealed these and all other issues. Due to the challenge of the provisions on its face, there is exposure as to the entire $750 million per year collected under Proposition 10 together with interest, which could amount to several billion dollars by the time the case is finally resolved.

In *FORCES Action Project et al. v. State of California et al.*, various smokers rights groups challenge the 1998 Master Settlement Agreement as it pertains to California, Utah and the City and County of San Francisco. Plaintiffs assert a variety of constitutional challenges, including that the settlement represents an unlawful tax on smokers. Motions to dismiss by all defendants, including the tobacco companies, were eventually converted to summary judgment motions by the court and heard on September 17, 1999. On January 5, 2000, the court dismissed the complaint for lack of subject matter jurisdiction because the plaintiffs lacked standing to sue. The court also concluded that the plaintiffs' claims against the State and its officials are barred by the 11th Amendment. On August 15, 2001, the 9th Circuit Court of Appeals affirmed the district court's dismissal of plaintiffs' claims but remanded the case to the district court to rule on whether plaintiffs should be allowed to amend their complaint to make a claim for injunctive relief under the federal antitrust laws. Plaintiffs have filed a motion to amend their complaint. The motion will be heard on December 18, 2001.

Arnett v. *California Public Employees Retirement System, et. al.* was filed by seven former employees of the State of California and local agencies, seeking back wages, damages and injunctive relief. Plaintiffs are former public safety members who began employment after the age of 40 and are recipients of Industrial Disability Retirement ("IDR") benefits. Plaintiffs contend that the formula which determines the amount of IDR benefits violates the federal Age Discrimination in Employment Act of 1967 ("ADEA"). Plaintiffs contend that, but for their ages at hire, they would receive increased monthly IDR benefits similar to their younger counterparts who began employment before the age of 40. CalPERS has estimated the liability to the State as approximately $315.5 million were the plaintiffs to prevail. The District Court dismissed the complaint for failure to state a claim. On August 17, 1999, the Ninth Circuit Court of Appeals reversed the District Court's dismissal of the complaint. The State sought further review in the United States Supreme Court. On January 11, 2000, the United States Supreme Court in *Kimel v. Florida Board of Regents*, held that Congress did not abrogate the sovereign immunity of the states when it enacted the ADEA. Thereafter, on January 18, 2000, the Supreme Court granted the petition for writ of certiorari in *Arnett,* vacated the judgment of the Ninth Circuit, and remanded the case to the Ninth Circuit for further proceedings consistent with *Kimel.* In turn, the Ninth Circuit remanded the case to the District Court. Thereafter, the EEOC intervened in this action. In December 2000, the State filed a motion for summary judgment based on sovereign immunity and constitutional grounds. Prior to a ruling on that motion, the plaintiffs and State defendants reached a partial settlement of the ADEA claim and are now in the process of forming a class action proceeding to address issues pertaining to local public entities. No trial date is set.

On March 30, 2000, a group of students, parents, and community based organizations brought suit, on behalf of the school children of the Los Angeles Unified School District, against the State Allocation Board ("SAB"), the State Office of Public School Construction ("OPSC") and a number of State officials (*Godinez, et al. v. Davis, et al.*) in the Superior Court in the County of Los Angeles. The lawsuit principally alleges SAB and OPSC have unconstitutionally and improperly allocated new public school construction funds to local school districts for new public school construction as authorized by the Class Size Reduction Kindergarten-University Public Education Facilities Bond Act (hereafter referred to as "Proposition 1A"). Plaintiffs seek only prospective relief, alleging that the current SAB method of allocating new construction funds is neither reasonable nor fair to large, urban school districts. The Plaintiffs allege the present allocation method does not dispense new construction funds on a priority of greatest need basis. On December 13, 2000, the parties reached an agreement under which plaintiffs and intervenors agree that the regulations adopted by the State Allocation Board at its meeting of that date, adequately address the needs of LAUSD. Assuming no future substantive changes in the regulations, the lawsuit will not go forward and will eventually be dismissed. On or about December 8, 2000, a related lawsuit was filed in Sacramento County Superior Court by the Coalition for Adequate School Housing ("CASH"). That case has since been transferred to Los Angeles County Superior Court. CASH seeks a writ of mandate against the State Allocation Board to prevent the distribution of new school construction funds according to the newly adopted regulations. CASH seeks distribution of the new school construction funds on a first come, first served basis. The SAB has filed an answer. The CASH petition was denied on September 25, 2001 and the court ordered the action dismissed in its entirety. The Attorney General is of the opinion that neither the Godinez nor the CASH lawsuit affects the validity of any State bonds, nor the authority of the State to issue bonds under the current authorization granted by the finance committees.

In *Charles Davis v. California Health and Human Services Agency*, the plaintiff has brought a class action under a number of federal acts, including the Americans with Disabilities Act, seeking declaratory and injunctive relief, alleging that persons who are institutionalized with disabilities at a San Francisco run 1,200 bed skilled nursing facility (Laguna Honda) who require long term care should be assessed as to whether they can be treated at home or in community-based facilities, and then provided appropriate care. The State has filed an answer. The City and County of San Francisco, co-defendants, filed a motion to dismiss which was in part granted based upon new case law. Plaintiffs filed an amended complaint. At this early stage in the proceedings, it is difficult to assess the financial impact of a judgment against the State. However, should the plaintiff prevail, the State's liability could exceed $400 million. The State is vigorously defending this action.

In *Stephen Sanchez, et al. v. Grantland Johnson et al.,* the plaintiffs have brought a class action in Federal District Court for the Northern District of California, seeking declaratory and injunctive relief, alleging, in part, that provider rates for community-based services for developmentally disabled individuals are discriminatory under the Americans with Disabilities Act, and violate Social Security Act, Civil Rights Act and the Rehabilitation Act, because they result in unnecessary institutionalization of developmentally disabled persons. The State has filed a responsive pleading and is vigorously contesting this case. At this early stage in the proceedings, it is difficult to assess the financial impact of a judgment against the State. However, should the plaintiffs prevail, the State's liability could exceed $400 million.

Litigation Relating to Energy Matters

Actions Seeking Compensation for Block Forward Contracts Commandeered by the Governor

The California Power Exchange ("PX" or "Power Exchange") has filed a claim with the State Victim Compensation and Government Claims Board (the "Board") seeking compensation from the State as a result of the commandeering by the Governor under Executive Orders of certain block forward power purchase contracts from Pacific Gas and Electric Company ("PG&E") in February 2001. The claim asserts the value of the PG&E contracts to be approximately $380.2 million. The State disputes the amount of this claim. In addition, PG&E has filed claims with the Board seeking unspecified amounts of compensation in the form of damages resulting from the commandeering of the block forward contracts. SCE has agreed to withdraw its claim against the State, upon finalization of the SCE and PUC settlement (See discussion, "Recent Developments Regarding Energy – Litigation – *Other Energy-Related Bankruptcies*".) Consequently, SCE's claim has been severed from, and will no longer be considered along with the other claims in, the consolidated proceedings.

Both PG&E and the PX have filed for protection under Chapter 11 of the federal Bankruptcy Code. (See "Recent Developments Regarding Energy -- Litigation -- *Pacific Gas and Electric Bankruptcy and Related Adversary Proceedings* and -- *Other Energy-Related Bankruptcies*".)

As of August 17, 2001, the Board had received approximately 30 additional claims from power producers and generators each of which is claiming an interest in the commandeered block forward contracts. The PX amended its original March 16, 2001 claim to include claims on behalf of all market participants for whose benefit the PX claimed the right to liquidate the commandeered block forward contracts referred to in its original claim. The administrative law judge selected by the Board to try the matter has found that the PX has identified and is representing all parties properly before the Board. The Board has scheduled argument on the value of the block forward contracts for February 27, 2002. However, the PX, PG&E and several power generators have objected to the Board proceedings, claiming that the Board no longer has jurisdiction over the parties because, *inter alia*, the State waived its administrative remedies by filing a declaratory relief action in superior court. They have stated their intent to challenge the jurisdiction of the Board in the coordinated case which includes the State's declaratory relief action and three inverse condemnation actions. (See discussion below).

In addition to the administrative action before the Board, the State was served with three inverse condemnation complaints arising from the Governor's commandeering of the block forward contracts. *Pacific Gas and Electric Company v. The State of California* was filed in San Francisco County Superior Court on July 16, 2001. *California Power Exchange Corporation v. State of California* and *Reliant Energy Services, Inc. v. The State of California* were filed in Los Angeles County Superior Court on July 20, 2001. Each plaintiff seeks unspecified amounts as just compensation and related damages for the alleged taking of their respective competing claims to the block forward contracts resulting from the Governor's commandeering. The State has filed demurrers to the complaints in each of the actions.

The People of the State of California, acting by and through DWR, have also filed a declaratory relief action in Sacramento Superior Court *(People of the State of California v. ACN Energy Inc., et al.* (No. 01A505497)) seeking a declaration regarding the extent of the State's liability, if any, for damages or compensation arising from the Governor's commandeering of the block forward contracts and a declaration that any entity that has not filed a claim with the Board is barred from claiming damages in any other action. Defendant Duke Energy has filed a Notice of Removal to federal district court. DWR has petitioned for removal to state court. The petition will be heard January 14, 2002.

In September 2001, the State filed motions for relief from automatic stay in the PX and PG&E bankruptcies. On October 1, 2001, Official Committee of Participant Creditors of the State, the PX, PG&E, and Reliant stipulated, among other things, to orders in the PX and PG&E bankruptcy actions granting relief from the automatic stay to the extent necessary to permit the prosecution and defense to final judgment of any actions or claims as to whether, how much, and to whom the State may be adjudged to pay, if anything, for the actions taken pursuant to the Executive Orders, including specifically the three inverse condemnation actions and the declaratory relief action. The parties to the stipulation also agreed to coordination of the State's declaratory relief action and the three inverse condemnation actions in a single coordinated case. On October 12, 2001, the coordination motion judge determined that coordination was appropriate and designated Sacramento County Superior Court for assignment to a coordination trial judge.

STATE DEBT TABLES

The tables which follow provide information on outstanding State debt, authorized but unissued general obligation bonds and commercial paper notes, debt service requirements for State general obligation and lease-purchase bonds, and authorized and outstanding State revenue bonds. For purposes of these tables, "General Fund bonds," also known as "non-self liquidating bonds," are general obligation bonds expected to be paid from the General Fund without reimbursement from any other fund. Although the principal of general obligation commercial paper notes in the "non-self liquidating" category is legally payable from the General Fund, the State expects that principal of such commercial paper notes will be paid only from the issuance of new commercial paper notes or the issuance of long-term general obligation bonds to retire the commercial paper notes. Interest on "non-self liquidating" general obligation commercial paper notes is payable from the General Fund.

"Enterprise Fund bonds," also known as "self liquidating bonds," are general obligation bonds for which program revenues are expected to be sufficient to reimburse in full the General Fund for debt service payments, but any failure to make such a reimbursement does not affect the obligation of the State to pay principal and interest on the bonds from the General Fund.

The tables following do not reflect the issuance of $1,000,000,000 of General Obligation Bonds on November 7, 2001, which retired outstanding commercial paper notes. As of November 13, 2001, the total amount of General Obligation Commercial Paper Notes outstanding was $319,480,000, not including notes scheduled to be retired from the bond sale.

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OUTSTANDING STATE DEBT
FISCAL YEARS 1996-97 THROUGH 2000-01
(Dollars in Thousands Except for Per Capita Information)

	1996-97	1997-98	1998-99	1999-00	2000-01
Outstanding Debt(a)					
General Obligation Bonds					
General Fund (Non-Self Liquidating)	$ 14,250,536	$ 14,932,766	$ 16,202,211	$ 17,877,880	$ 20,472,893
Enterprise Fund (Self Liquidating)	3,699,060	3,906,950	3,674,020	3,474,900	3,396,215
Total	$ 17,949,596	$ 18,839,716	$ 19,876,231	$ 21,352,780	$ 23,869,108
Lease-Purchase Debt	6,175,044	6,639,620	6,671,534	6,627,944	6,413,260
Total Outstanding General Obligation Bonds and Lease-Purchase Debt	$ 24,124,640	$ 25,479,336	$ 26,547,765	$ 27,980,724	$ 30,282,368
Bond Sales During Fiscal Year					
Non-Self Liquidating General Obligation Bonds	$ 1,025,000	$ 1,667,820	$ 2,294,650	$ 2,750,000	$ 4,419,665
Self Liquidating General Obligation Bonds	$ 0	$ 447,535	$ 80,000	$ 126,500	$ 358,625
Lease-Purchase Debt	$ 1,257,630	$ 1,245,190	$ 456,410	$ 293,235	$ 214,585
Debt Service(b)					
Non-Self Liquidating General Obligation Bonds	$ 1,946,333	$ 1,878,026	$ 1,934,628	$ 2,045,566	$ 2,279,636
Lease-Purchase Debt	$ 532,783	$ 577,987	$ 652,131	$ 654,485	$ 670,228
General Fund Receipts(b)	$ 49,831,217	$ 55,261,557	$ 58,510,860	$ 72,226,473	$ 78,330,406
Non-Self Liquidating General Obligation Bonds Debt Service as a Percentage of General Fund Receipts	3.91%	3.40%	3.31%	2.83%	2.91%
Lease-Purchase Debt Service as a Percentage of General Fund Receipts	1.07%	1.05%	1.11%	0.91%	0.86%
Population(c)	32,383,000	32,957,000	33,494,000	34,036,000	34,818,000
Non-Self Liquidating General Obligation Bonds Outstanding Per Capita	$ 440.06	$ 453.10	$ 483.73	$ 525.26	$ 588.00
Lease-Purchase Debt Outstanding Per Capita	$ 190.69	$ 201.46	$ 199.19	$ 194.73	$ 184.19
Personal Income(d)	$ 862,114,000	$ 924,253,000	$ 991,382,000	$1,105,700,000	$1,128,200,000
Non-Self Liquidating General Obligation Bonds Outstanding as Percentage of Personal Income	1.65%	1.62%	1.63%	1.62%	1.81%
Lease-Purchase Debt Outstanding as Percentage of Personal Income	0.72%	0.72%	0.67%	0.60%	0.57%

(a) As of last day of fiscal year
(b) Calculated on a cash basis; debt service costs of bonds issued in any fiscal year largely appear in subsequent fiscal year.
(c) As of July 1, the beginning of the fiscal year.
(d) Calendar year in which fiscal year ends: 2000 actual; 2001 consistent with May Revision.

SOURCES: Population: State of California, Department of Finance
Personal Income: State of California, Department of Finance; United States, Department of Commerce
Outstanding Debt, Bonds Sales During Fiscal Year and Debt Service: State of California, Office of the Treasurer.
General Fund Receipts: State of California, Office of the State Controller.

AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS

As of September 1, 2001

(Thousands)

	Voter Authorization		Bonds	CP Program	
	Date	Amount	Outstanding	Authorized (a)	Unissued (b)
GENERAL FUND BONDS (Non-Self Liquidating)					
California Earthquake Safety and Housing Rehabilitation Bond Act of 1988	6/7/88	$ 150,000	$ 0	$ n.a.	$ 0
California Library Construction and Renovation Bond Act of 1988	11/8/88	75,000	48,650	695	1,900
California Library Construction and Renovation Bond Act of 2000	3/7/00	350,000	500	900	348,600
California Park and Recreational Facilities Act of 1984	6/5/84	370,000	161,275	n.a.	1,100
California Parklands Act of 1980	11/4/80	285,000	44,460	n.a.	0
California Safe Drinking Water Bond Law of 1976	6/8/76	175,000	52,460	n.a.	2,500
California Safe Drinking Water Bond Law of 1984	11/6/84	75,000	32,095	n.a.	0
California Safe Drinking Water Bond Law of 1986	11/4/86	100,000	66,705	n.a.	0
California Safe Drinking Water Bond Law of 1988	11/8/88	75,000	48,300	6,265	2,000
California Wildlife, Coastal, and Park Land Conservation Act of 1988	6/7/88	776,000	461,750	n.a.	14,980
Class Size Reduction Public Education Facilities Bond Act of 1998 (Hi Ed)	11/3/98	2,500,000	485,740	414,170	1,593,000
Class Size Reduction Public Education Facilities Bond Act of 1998 (K-12)	11/3/98	6,700,000	4,563,645	2,007,300	0
Clean Air and Transportation Improvement Bond Act of 1990	6/5/90	1,990,000	1,213,115	85,925	315,300
Clean Water and Water Conservation Bond Law of 1978	6/6/78	375,000	57,660	n.a.	0
Clean Water and Water Reclamation Bond Law of 1988	11/8/88	65,000	46,425	0	0
Clean Water Bond Law of 1970	11/3/70	250,000	5,000	n.a.	0
Clean Water Bond Law of 1974	6/4/74	250,000	10,225	n.a.	0
Clean Water Bond Law of 1984	11/6/84	325,000	96,725	n.a.	0
Community Parklands Act of 1986	6/3/86	100,000	49,660	n.a.	0
County Correctional Facility Capital Expenditure and Youth Facility Bond Act of 1988	11/8/88	500,000	311,230	0	0
County Correctional Facility Capital Expenditure Bond Act of 1986	6/3/86	495,000	255,375	n.a.	0
County Jail Capital Expenditure Bond Act of 1981	11/2/82	280,000	81,375	n.a.	0
County Jail Capital Expenditure Bond Act of 1984	6/5/84	250,000	72,400	n.a.	0
Earthquake Safety and Public Buildings Rehabilitation Bond Act of 1990	6/5/90	300,000	159,855	115,000	0
Fish and Wildlife Habitat Enhancement Act of 1984	6/5/84	85,000	32,870	n.a.	3,000
Hazardous Substance Cleanup Bond Act of 1984	11/6/84	100,000	12,000	n.a.	0
Higher Education Facilities Bond Act of 1986	11/4/86	400,000	168,900	n.a.	0
Higher Education Facilities Bond Act of 1988	11/8/88	600,000	293,100	3,805	7,000
Higher Education Facilities Bond Act of June 1990	6/5/90	450,000	254,620	7,000	1,000
Higher Education Facilities Bond Act of June 1992	6/2/92	900,000	666,270	7,410	8,700
Housing and Homeless Bond Act of 1988	11/8/88	300,000	2,300	n.a.	0
Housing and Homeless Bond Act of 1990	6/5/90	150,000	7,855	n.a.	0
Lake Tahoe Acquisitions Bond Act	8/2/82	85,000	34,605	n.a.	0

AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS

As of September 1, 2001

(Thousands)

	Voter Authorization		Bonds	CP Program	
	Date	Amount	Outstanding	Authorized (a)	Unissued (b)
GENERAL FUND BONDS (Non-Self Liquidating)					
California Earthquake Safety and Housing Rehabilitation Bond Act of 1988	6/7/88	$ 150,000	$ 0	$ n.a.	$ 0
California Library Construction and Renovation Bond Act of 1988	11/8/88	75,000	48,650	695	1,900
California Library Construction and Renovation Bond Act of 2000	3/7/00	350,000	500	900	348,600
California Park and Recreational Facilities Act of 1984	6/5/84	370,000	161,275	n.a.	1,100
California Parklands Act of 1980	11/4/80	285,000	44,460	n.a.	0
California Safe Drinking Water Bond Law of 1976	6/8/76	175,000	52,460	n.a.	2,500
California Safe Drinking Water Bond Law of 1984	11/6/84	75,000	32,095	n.a.	0
California Safe Drinking Water Bond Law of 1986	11/4/86	100,000	66,705	n.a.	0
California Safe Drinking Water Bond Law of 1988	11/8/88	75,000	48,300	6,265	2,000
California Wildlife, Coastal, and Park Land Conservation Act of 1988	6/7/88	776,000	461,750	n.a.	14,980
Class Size Reduction Public Education Facilities Bond Act of 1998 (Hi Ed)	11/3/98	2,500,000	485,740	414,170	1,593,000
Class Size Reduction Public Education Facilities Bond Act of 1998 (K-12)	11/3/98	6,700,000	4,563,645	2,007,300	0
Clean Air and Transportation Improvement Bond Act of 1990	6/5/90	1,990,000	1,213,115	85,925	315,300
Clean Water and Water Conservation Bond Law of 1978	6/6/78	375,000	57,660	n.a.	0
Clean Water and Water Reclamation Bond Law of 1988	11/8/88	65,000	46,425	0	0
Clean Water Bond Law of 1970	11/3/70	250,000	5,000	n.a.	0
Clean Water Bond Law of 1974	6/4/74	250,000	10,225	n.a.	0
Clean Water Bond Law of 1984	11/6/84	325,000	96,725	n.a.	0
Community Parklands Act of 1986	6/3/86	100,000	49,660	n.a.	0
County Correctional Facility Capital Expenditure and Youth Facility Bond Act of 1988	11/8/88	500,000	311,230	0	0
County Correctional Facility Capital Expenditure Bond Act of 1986	6/3/86	495,000	255,375	n.a.	0
County Jail Capital Expenditure Bond Act of 1981	11/2/82	280,000	81,375	n.a.	0
County Jail Capital Expenditure Bond Act of 1984	6/5/84	250,000	72,400	n.a.	0
Earthquake Safety and Public Buildings Rehabilitation Bond Act of 1990	6/5/90	300,000	159,855	115,000	0
Fish and Wildlife Habitat Enhancement Act of 1984	6/5/84	85,000	32,870	n.a.	3,000
Hazardous Substance Cleanup Bond Act of 1984	11/6/84	100,000	12,000	n.a.	0
Higher Education Facilities Bond Act of 1986	11/4/86	400,000	168,900	n.a.	0
Higher Education Facilities Bond Act of 1988	11/8/88	600,000	293,100	3,805	7,000
Higher Education Facilities Bond Act of June 1990	6/5/90	450,000	254,620	7,000	1,000
Higher Education Facilities Bond Act of June 1992	6/2/92	900,000	666,270	7,410	8,700
Housing and Homeless Bond Act of 1988	11/8/88	300,000	2,300	n.a.	0
Housing and Homeless Bond Act of 1990	6/5/90	150,000	7,855	n.a.	0
Lake Tahoe Acquisitions Bond Act	8/2/82	85,000	34,605	n.a.	0

AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS
(Continued)

	Voter Authorization Date	Voter Authorization Amount	Bonds Outstanding	CP Program Authorized (a)	Unissued (b)
New Prison Construction Bond Act of 1981	6/8/82	$ 495,000	$ 88,750	$ n.a.	$ 0
New Prison Construction Bond Act of 1984	6/5/84	300,000	67,500	n.a.	0
New Prison Construction Bond Act of 1986	11/4/86	500,000	222,715	n.a.	1,500
New Prison Construction Bond Act of 1988	11/8/88	817,000	410,370	3,860	8,400
New Prison Construction Bond Act of 1990	6/5/90	450,000	248,170	8,100	0
Passenger Rail and Clean Air Bond Act of 1990	6/5/90	1,000,000	606,175	13,900	0
Public Education Facilities Bond Act of 1996	3/26/96	3,000,000	2,540,780	191,485	8,700
1988 School Facilities Bond Act	11/8/88	800,000	411,565	7,000	0
1990 School Facilities Bond Act	6/5/90	800,000	452,400	3,745	0
1992 School Facilities Bond Act	11/3/92	900,000	613,888	12,094	0
Safe, Clean Reliable Water Supply Act of 1996	11/5/96	995,000	275,065	194,200	511,800
Safe Drinking Water Bond Act of 2000	3/7/00	1,970,000	54,000	270,200	1,645,800
Safe Neighborhood Parks Bond Act of 2000	3/7/00	2,100,000	138,500	448,500	1,513,000
School Building and Earthquake Bond Act of 1974	11/5/74	40,000	33,325	n.a.	0
School Facilities Bond Act of 1988	6/7/88	800,000	372,490	n.a.	0
School Facilities Bond Act of 1990	11/6/90	800,000	471,080	6,500	0
School Facilities Bond Act of 1992	6/2/92	1,900,000	1,213,410	33,400	0
Seismic Retrofit Bond Act of 1996	3/26/96	2,000,000	1,174,875	289,645	448,000
Senior Center Bond Act of 1984	11/6/84	50,000	12,500	n.a.	0
State Beach, Park, Recreational and Historical Facilities Bonds	6/4/74	250,000	1,735	n.a.	0
State School Building Lease-Purchase Bond Law of 1982	11/2/82	500,000	68,855	n.a.	0
State School Building Lease-Purchase Bond Law of 1984	11/6/84	450,000	149,800	n.a.	0
State School Building Lease-Purchase Bond Law of 1986	11/4/86	800,000	355,000	n.a.	0
State, Urban, and Coastal Park Bond Act of 1976	11/2/76	280,000	17,900	n.a.	0
Veterans' Homes Bond Act of 2000	3/7/00	50,000	0	0	50,000
Water Conservation and Water Quality Bond Law of 1986	6/3/86	150,000	74,750	n.a.	31,000
Water Conservation Bond Law of 1988	11/8/88	60,000	33,260	12,935	3,000
Total General Fund Bonds		$ 42,138,000	$ 19,906,003	$ 4,144,034	$ 6,520,280
ENTERPRISE FUND BONDS (*Self Liquidating*)					
California Water Resources Development Bond Act of 1959	11/8/60	$ 1,750,000	$ 894,170	$ n.a.	$ 167,600
Veterans Bonds	(c)	4,510,000	2,415,765	0	105,585
Total Enterprise Fund Bonds		$ 6,260,000	$ 3,309,935	$ 0	$ 273,185
TOTAL GENERAL OBLIGATION BONDS		$ 48,398,000	$ 23,215,938	$ 4,144,034	$ 6,793,465

(a) Total commercial paper authorized to be issued by the respective Finance Committees. Of this total $763,945,000 is outstanding as of September 1, 2001.
Pursuant to terms of the Finance Committee resolutions, no more than $1.5 billion of commercial paper can be outstanding at any one time.
Bond acts marked "n.a." are not legally permitted to utilize commercial paper, or all bonds were issued before the commercial paper program began.
(b) Treats full commercial paper authorization as issued; see footnote (a).
(c) Various dates.

SOURCE: State of California, Office of the Treasurer.

SCHEDULE OF DEBT SERVICE REQUIREMENTS
FOR GENERAL FUND GENERAL OBLIGATION BONDS(a)
(Non-Self Liquidating)
As of September 1, 2001

Fiscal Year Ending June 30	Current Debt		
	Interest	Principal (b)	Total
2002	$ 874,425,943.56	$ 843,145,000.00	$ 1,717,570,943.56 (c)
2003	1,058,899,363.89	1,359,256,391.80	2,418,155,755.69
2004	969,881,996.70	1,285,250,000.00	2,255,131,996.70
2005	893,570,322.59	1,198,559,388.71	2,092,129,711.30
2006	821,458,525.00	1,127,940,000.00	1,949,398,525.00
2007	754,380,678.43	1,097,725,000.00	1,852,105,678.43
2008	693,775,417.93	1,067,638,078.31	1,761,413,496.24
2009	631,270,018.75	1,058,925,000.00	1,690,195,018.75
2010	569,102,118.06	1,003,245,000.00	1,572,347,118.06
2011	513,229,248.59	916,704,045.16	1,429,933,293.75
2012	457,879,050.05	673,245,000.00	1,131,124,050.05
2013	421,312,501.25	592,175,000.00	1,013,487,501.25
2014	392,061,455.89	465,640,000.00	857,701,455.89
2015	368,762,569.69	493,840,000.00	862,602,569.69
2016	342,850,463.96	472,060,000.00	814,910,463.96
2017	317,172,344.60	494,755,000.00	811,927,344.60
2018	291,548,850.98	497,620,000.00	789,168,850.98
2019	265,709,131.00	496,585,000.00	762,294,131.00
2020	239,953,343.50	492,885,000.00	732,838,343.50
2021	215,285,669.75	491,560,000.00	706,845,669.75
2022	189,724,003.50	534,290,000.00	724,014,003.50
2023	161,244,467.70	536,610,000.00	697,854,467.70
2024	134,703,627.84	466,870,000.00	601,573,627.84
2025	110,959,144.08	427,520,000.00	538,479,144.08
2026	88,963,335.09	389,740,000.00	478,703,335.09
2027	68,608,960.09	373,100,000.00	441,708,960.09
2028	49,593,301.59	355,600,000.00	405,193,301.59
2029	32,329,200.00	304,395,000.00	336,724,200.00
2030	17,118,930.75	245,125,000.00	262,243,930.75
2031	5,435,802.00	144,000,000.00	149,435,802.00
Total	**$ 11,951,209,786.81**	**$ 19,906,002,903.98**	**$ 31,857,212,690.79**

(a) Does not include commercial paper outstanding.

(b) Includes scheduled mandatory sinking fund payments as well as serial maturities.

(c) Total represents the remaining debt service requirements from October 1, 2001 through June 30, 2002.

SOURCE: State of California, Office of the Treasurer.

SCHEDULE OF DEBT SERVICE REQUIREMENTS FOR ENTERPRISE FUND GENERAL OBLIGATION BONDS(a)
(Self Liquidating)
As of September 1, 2001

Fiscal Year Ending June 30	Current Debt		
	Interest	Principal (b)	Total
2002	$ 170,909,141.00	$ 99,725,000.00	$ 270,634,141.00 (c)
2003	184,866,358.85	111,010,000.00	295,876,358.85
2004	176,776,025.00	116,875,000.00	293,651,025.00
2005	168,308,482.25	131,840,000.00	300,148,482.25
2006	158,911,643.50	145,455,000.00	304,366,643.50
2007	148,328,274.76	176,545,000.00	324,873,274.76
2008	136,186,347.29	187,905,000.00	324,091,347.29
2009	124,097,996.25	178,725,000.00	302,822,996.25
2010	112,511,531.55	168,695,000.00	281,206,531.55
2011	102,916,115.77	126,905,000.00	229,821,115.77
2012	95,403,531.00	169,860,000.00	265,263,531.00
2013	87,057,805.62	171,035,000.00	258,092,805.62
2014	79,641,787.25	137,615,000.00	217,256,787.25
2015	73,474,728.15	136,930,000.00	210,404,728.15
2016	66,447,320.75	142,760,000.00	209,207,320.75
2017	58,942,136.89	134,615,000.00	193,557,136.89
2018	52,575,891.59	115,005,000.00	167,580,891.59
2019	47,059,140.46	111,490,000.00	158,549,140.46
2020	41,881,023.05	77,270,000.00	119,151,023.05
2021	37,469,152.54	72,030,000.00	109,499,152.54
2022	33,279,411.14	69,170,000.00	102,449,411.14
2023	29,172,174.39	51,280,000.00	80,452,174.39
2024	26,194,960.64	54,280,000.00	80,474,960.64
2025	23,044,337.50	57,400,000.00	80,444,337.50
2026	19,702,415.00	85,285,000.00	104,987,415.00
2027	15,139,873.75	70,710,000.00	85,849,873.75
2028	11,045,517.50	31,555,000.00	42,600,517.50
2029	9,054,558.75	38,700,000.00	47,754,558.75
2030	6,964,157.50	35,130,000.00	42,094,157.50
2031	5,026,465.00	32,815,000.00	37,841,465.00
2032	3,093,192.50	34,670,000.00	37,763,192.50
2033	1,049,983.75	36,650,000.00	37,699,983.75
Total	**$ 2,306,531,480.94**	**$ 3,309,935,000.00**	**$ 5,616,466,480.94**

(a) Does not include commercial paper outstanding.
(b) Includes scheduled mandatory sinking fund payments as well as serial maturities.
(c) Total represents the remaining debt service requirements from October 1, 2001 through June 30, 2002.

SOURCE: State of California, Office of the Treasurer.

SCHEDULE OF DEBT SERVICE REQUIREMENTS
FOR LEASE-PURCHASE DEBT
As of September 1, 2001

Fiscal Year Ending June 30	Current Debt			
	Interest	Principal (a)	Total	
2002	$ 290,362,491.85	253,255,000.00	$ 543,617,491.85	(b)
2003	328,353,831.76	305,746,118.58	634,099,950.34	
2004	312,467,474.47	313,846,386.24	626,313,860.71	
2005	297,868,984.05	327,844,507.20	625,713,491.25	
2006	278,662,190.93	346,882,554.60	625,544,745.53	
2007	265,854,480.09	299,063,920.44	564,918,400.53	
2008	247,569,233.60	306,366,787.98	553,936,021.58	
2009	235,640,243.18	327,507,732.44	563,147,975.62	
2010	213,032,047.34	315,131,633.76	528,163,681.10	
2011	185,285,977.24	326,715,000.00	512,000,977.24	
2012	167,927,108.81	308,870,000.00	476,797,108.81	
2013	151,492,084.95	316,275,000.00	467,767,084.95	
2014	134,779,824.73	317,805,000.00	452,584,824.73	
2015	117,529,875.98	334,735,000.00	452,264,875.98	
2016	99,582,410.94	314,270,000.00	413,852,410.94	
2017	82,362,000.71	317,335,000.00	399,697,000.71	
2018	65,527,503.09	329,845,000.00	395,372,503.09	
2019	48,502,722.79	286,345,000.00	334,847,722.79	
2020	33,504,462.45	254,110,000.00	287,614,462.45	
2021	21,615,555.38	185,190,000.00	206,805,555.38	
2022	11,956,658.73	152,615,000.00	164,571,658.73	
2023	5,634,088.15	95,055,000.00	100,689,088.15	
2024	1,404,390.63	15,155,000.00	16,559,390.63	
2025	478,230.00	16,120,000.00	16,598,230.00	
Total	**$ 3,597,393,871.85**	**$ 6,366,084,641.24**	**$ 9,963,478,513.09**	

(a) Includes scheduled mandatory sinking fund payments as well as serial maturities.
(b) Total represents the remaining debt service requirements from October 1, 2001 through June 30, 2002.

SOURCE: State of California, Office of the Treasurer.

STATE PUBLIC WORKS BOARD AND OTHER LEASE-PURCHASE FINANCING OUTSTANDING ISSUES

September 1, 2001

Name of Issue		Outstanding
GENERAL FUND SUPPORTED ISSUES:		
State Public Works Board		
California Community Colleges	$	596,890,000
Department of the Youth Authority		8,510,000
Department of Corrections *		2,456,081,947
Energy Efficiency Program (Various State Agencies) (a)		98,310,000
The Regents of The University of California * (b)		1,031,077,694
Trustees of The California State University		645,050,000
Various State Office Buildings		544,120,000
Total State Public Works Board Issues	**$**	**5,380,039,641**
Total Other State Building Lease Purchase Issues (c)	**$**	**952,060,000**
Total General Fund Supported Issues	**$**	**6,332,099,641**
SPECIAL FUND SUPPORTED ISSUES:		
East Bay State Building Authority Certificates of Participation (State of California Department of Transportation) *	$	75,258,050
San Bernardino Joint Powers Financing Authority (State of California Department of Transportation)		58,950,000
San Francisco State Building Authority (State of California Department of General Services Lease) (d)		47,005,000
Total Special Fund Supported Issues	**$**	**181,213,050**
TOTAL	**$**	**6,513,312,691**

* Includes the initial value of capital appreciation bonds rather than the accreted value.

(a) This program is self-liquidating based on energy cost savings.

(b) The Regents' obligations to the State Public Works Board are payable from lawfully available funds of The Regents which are held in The Regents' treasury funds and are separate from the State General Fund. A portion of The Regents' annual budget is derived from General Fund appropriations.

(c) Includes $191,435,000 Sacramento City Financing Authority Lease Revenue Bonds State of California - Cal EPA Building, 1998 Series A, which are supported by lease rentals from the California Environmental Protection Agency; these rental payments are subject to annual appropriation by the State Legislature.

(d) The sole tenant is the California Public Utilities Commission.

SOURCE: State of California, Office of the Treasurer.

STATE AGENCY REVENUE BONDS
AND CONDUIT FINANCING
As of June 30, 2001

Issuing Agency		Outstanding[a]
State Programs Financing:		
California State University	$	487,388,000
California Transportation Commission		--
Department of Water Resources - Central Valley Project		2,459,345,000
Department of Water Resources - Power Supply Program [b]		-
The Regents of the University of California		3,111,890,000
Trade and Commerce Agency		--
Housing Financing:		
California Housing Finance Agency		7,825,374,039
Veterans Revenue Debenture		570,940,000
Conduit Financing:		
California Alternative Energy and Advanced Transportation Financing Authority		59,110,000
California Educational Facilities Authority		2,493,564,950
California Health Facilities Financing Authority		6,186,040,711
California Infrastructure and Economic Development Bank [c] [d]		845,499,044
California Passenger Rail Financing Commission		--
California Pollution Control Financing Authority		4,895,384,480
California School Finance Authority		130,000
California Student Loan Authority		100,260,000
California Urban Waterfront Area Restoration Financing Authority		--
TOTAL	**$**	**29,034,926,224**

[a] Total Outstanding does not include defeased bonds and includes the accreted values for capital appreciation bonds.

[b] Does not include a $4.3 billion bridge loan, from a group of investment and commercial banks, under this program. The Department expects to repay the loan from proceeds of revenue bonds sold under this program.

[c] Does not include $6.0 billion of "rate reduction bonds" issued by special purpose trusts for the benefit of four investor-owned electric utility companies representing interests in certain electric rate surcharges.

[d] California Economic Development Financing Authority merged with California Infrastructure and Economic Development Bank effective January 1, 1999.

SOURCE: State of California, Office of the Treasurer.

EXHIBIT 1

STATEMENT of GENERAL FUND CASH RECEIPTS and DISBURSEMENTS

June 2001

KATHLEEN CONNELL
California State Controller

KATHLEEN CONNELL

Controller of the State of California

July 10, 2001

Users of the Statement of General Fund Cash Receipts and Disbursements

Attached are the Statements of General Fund Cash Receipts and Disbursements for the period July 1, 2000 through June 30, 2001. These statements reflect the State of California's General Fund cash position and compare actual receipts and disbursements for the 2000-01 fiscal year to cash flow estimates prepared by the Department of Finance for the 2001-02 May Revision as well as the 2000-01 Budget Act. These statements are prepared in compliance with Government Code Section 12461.1, as well as Item 0840-001-0001, Provision 10, of the 2000-01 Budget Act, using records compiled by the State Controller.

Attachment A compares actual receipts and disbursements to date for the 2000-01 fiscal year to cash flow estimates published in the 2001-02 May Revision. The May Revision cash flow reflects an expected increase of $4.7 billion in receipts from the Budget Act estimates for the 2000-01 fiscal year, and an expected increase of $4.0 billion in disbursements, $6.2 billion of which are for energy purchases. These cash flow estimates are predicated on projections and assumptions made by the Department of Finance in preparation of the May Revision.

Attachment B compares actual receipts and disbursements to date for the 2000-01 fiscal year to cash flow estimates prepared by the Department of Finance based upon the 2000-01 Budget Act. Prior year actual amounts are also displayed for comparative purposes.

These statements are also available on the Internet at the State Controller's homepage at **http://www.sco.ca.gov** under the category Statements of General Fund Cash Receipts and Disbursements.

Any questions concerning this report may be directed to Walter Barnes, Chief Deputy Controller, Finance at (916) 445-7447.

Sincerely,

KATHLEEN CONNELL
State Controller

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SACRAMENTO 300 Capitol Mall, Suite 1850, Sacramento, CA 95814 (916) 445-2636
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STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS
A Comparison of Actual to 2001-02 May Revision Estimates
(Amounts in thousands)
Attachment A

	July 1 through June 30				
	2001				2000
	Actual	Estimate (a)	Actual Over or (Under) Estimate Amount	%	Actual
GENERAL FUND BEGINNING CASH BALANCE	$ 8,531,322	$ 8,531,322	$ -	-	$ 847,936
Add Receipts:					
Revenues	77,587,204	77,802,000	(214,796)	(0.3)	70,771,088
Nonrevenues	743,202	672,126	71,076	10.6	1,455,385
Total Receipts	78,330,406	78,474,126	(143,720)	(0.2)	72,226,473
Less Disbursements:					
State Operations	18,433,133	17,929,366	503,767 (b)	2.8	16,149,149
Local Assistance	58,092,522	66,070,287	(7,977,765) (b)	(12.1)	47,885,824
Capital Outlay	1,866,906	2,342,673	(475,767)	(20.3)	183,764
Nongovernmental	5,074,890	179,879	4,895,011 (b)	2,721.3	324,350
Total Disbursements	83,467,451	86,522,205	(3,054,754)	(3.5)	64,543,087
Receipts Over / (Under) Disbursements	(5,137,045)	(8,048,079)	2,911,034	-	7,683,386
Net Increase / (Decrease) in Temporary Loans	-	-	-	-	-
GENERAL FUND ENDING CASH BALANCE	**3,394,277**	**483,243**	**2,911,034**	**602.4**	**8,531,322**
Special Fund for Economic Uncertainties (c)	204,486	307,641	(103,155)	(33.5)	816,081
TOTAL CASH	**$ 3,598,763**	**$ 790,884**	**$ 2,807,879**	**355.0**	**$ 9,347,403**
BORROWABLE RESOURCES					
Available Borrowable Resources	$ 12,342,385	$ 11,406,164	$ 936,221	8.2	$ 9,427,179
Outstanding Loans	-	-	-	-	-
Unused Borrowable Resources	$ 12,342,385	$ 11,406,164	$ 936,221	8.2	$ 9,427,179

General Note:
This report is based upon funded cash. Funded cash is cash reported to and recorded in the records of the State Controller's Office. Amounts reported as funded cash may differ from amounts in other reports to the extent there are timing differences in the recording of in-transit items.

Footnotes:
(a) A Statement of Estimated Cash Flow for the 2000-01 fiscal year prepared by the Department of Finance for the May Revision to the 2001-02 Governor's Budget. Any projections or estimates are set forth as such and not as representations of fact.
(b) These items contain transfers for energy purchases under the Governor's Emergency Proclamation. Those items with large overages are due to unanticipated purchases of energy, while items with underages reflect a smaller variance than truly exists. Recent activities not reflected in these figures include: (1) the Public Utilities Commission's decision to raise rates; (2) the delay in the sale of energy revenue bonds; (3) the Pacific Gas & Electric Company's bankruptcy; and (4) the recent agreement with Southern California Edison. All of these will have significant impacts on the General Fund in the future. To date, transfers from the General Fund for energy purchases totaled $5.9 billion.
(c) Includes the Disaster Response-Emergency Operations Account within the Special Fund for Economic Uncertainties.
(d) Negative balances are the result of repayments received that are greater than disbursements made.
(e) Excludes State School Building Bonds.

SCHEDULE OF CASH RECEIPTS
(Amounts in thousands)

	Month of June		July 1 through June 30				
			2001				2000
	2001	2000	Actual	Estimate (a)	Actual Over or (Under) Estimate Amount	%	Actual
REVENUES							
Alcoholic Beverage Excise Tax	$ 19,918	$ 24,249	$ 285,027	$ 288,000	$ (2,973)	(1.0)	$ 282,869
Bank and Corporation Tax	934,049	1,176,095	6,546,270	6,663,000	(116,730)	(1.8)	6,575,403
Cigarette Tax	11,265	14,666	126,743	127,000	(257)	(0.2)	135,982
Horse Racing Fees	1,601	3,679	3,866	-	3,866	-	5,249
Estate, Inheritance, and Gift Tax	78,370	78,373	1,109,757	1,101,000	8,757	0.8	923,296
Insurance Companies Tax	318,053	277,462	1,501,455	1,470,000	31,455	2.1	1,300,771
Personal Income Tax	3,651,320	3,944,920	44,772,001	44,736,000	36,001	0.1	39,272,755
Retail Sales and Use Taxes	1,734,402	2,050,843	21,290,637	21,414,000	(123,363)	(0.6)	20,825,007
Pooled Money Investment Interest	114,740	51,916	836,686	762,000	74,686	9.8	362,264
Not Otherwise Classified	60,493	(4,476)	1,114,762	1,241,000	(126,238)	(10.2)	1,087,492
Total Revenues	**6,924,211**	**7,617,727**	**77,587,204**	**77,802,000**	**(214,796)**	**(0.3)**	**70,771,088**
NONREVENUES							
Transfers from Special Fund for Economic Uncertainties	(64,085)	-	230,695	273,440	(42,745)	(15.6)	798,132
Transfers from Other Funds	21,858	25,586	171,463	158,034	13,429	8.5	338,986
Miscellaneous	30,609	18,219	341,044	240,652	100,392	41.7	318,267
Total Nonrevenues	**(11,618)**	**43,805**	**743,202**	**672,126**	**71,076**	**10.6**	**1,455,385**
Total Receipts	**$ 6,912,593**	**$ 7,661,532**	**$ 78,330,406**	**$ 78,474,126**	**$ (143,720)**	**(0.2)**	**$ 72,226,473**

See notes on page 1.

SCHEDULE OF CASH DISBURSEMENTS
(Amounts in thousands)

	Month of June		July 1 through June 30				
			2001				2000
	2001	2000	Actual	Estimate (a)	Actual Over or (Under) Estimate Amount	%	Actual
STATE OPERATIONS (d)							
Legislative/Judicial/Executive	$ 57,144	$ 45,270	$ 1,047,188	$ 1,002,166	$ 45,022	4.5	$ 930,695
State and Consumer Services	55,755	30,947	465,333	472,205	(6,872)	(1.5)	427,136
Business, Transportation and Housing	48	665,141	43,963	56,779	(12,816)	(22.6)	672,394
Trade and Commerce	3,621	3,738	48,083	49,315	(1,232)	(2.5)	33,933
Resources	14,462	64,485	1,816,778	1,052,829	763,949 (b)	72.6	749,314
Environmental Protection Agency	(31,370)	14,303	318,920	423,702	(104,782)	(24.7)	140,350
Health and Human Services:							
Health Services	45,469	(4,267)	253,520	283,196	(29,676)	(10.5)	207,380
Mental Health Hospitals	37,782	26,478	455,378	455,416	(38)	-	368,949
Other Health and Human Services	(14,727)	55,605	366,087	421,421	(55,334)	(13.1)	342,249
Education:							
University of California	99,700	5,130	3,160,156	3,203,901	(43,745)	(1.4)	2,717,404
State Universities and Colleges	238,357	188,464	2,399,161	2,459,822	(60,661)	(2.5)	2,179,442
Other Education	12,582	9,988	171,491	187,879	(16,388)	(8.7)	152,414
Corrections and Youth Authority	363,692	342,863	4,595,721	4,580,561	15,160	0.3	4,242,264
General Government	56,003	83,102	1,047,796	1,049,173	(1,377)	(0.1)	772,964
Public Employees Retirement System	(9,539)	(4,838)	(28,114)	(19,590)	(8,524)	-	126,119
Debt Service (e)	132,901	100,241	2,265,419	2,250,591	14,828	0.7	2,033,501
Interest on Loans	-	33,566	6,253	-	6,253	-	52,641
Total State Operations	**1,061,880**	**1,660,216**	**18,433,133**	**17,929,366**	**503,767**	**2.8**	**16,149,149**
LOCAL ASSISTANCE (d)							
Public Schools - K-12	1,473,777	1,250,244	26,063,406	27,228,874	(1,165,468)	(4.3)	22,114,415
Community Colleges	212,157	198,072	2,743,161	2,655,415	87,746	3.3	2,293,579
Contributions to State Teachers' Retirement System	-	-	902,353	902,353	-	-	936,528
Other Education	(128,606)	164,035	1,922,204	2,026,866	(104,662)	(5.2)	1,846,123
Corrections and Youth Authority	11,497	8,141	117,227	132,225	(14,998)	(11.3)	108,929
Dept. of Alcohol and Drug Program	(240)	2,155	169,919	188,807	(18,888)	(10.0)	84,642
Dept. of Health Services:							
Medical Assistance Program	812,626	627,551	8,762,549	9,143,089	(380,540)	(4.2)	8,121,578
Other Health Services	56,957	20,949	442,550	474,340	(31,790)	(6.7)	338,076
Dept. of Developmental Services	68,529	2,222	946,779	984,366	(37,587)	(3.8)	814,917
Dept. of Mental Health	(84,654)	40,016	363,011	426,581	(63,570)	(14.9)	301,917
Dept. of Social Services:							
SSI/SSP/IHSS	145,143	230,131	3,277,035	3,234,590	42,445	1.3	3,102,868
CalWORKs	101,237	70,368	2,757,458	2,765,255	(7,797)	(0.3)	2,359,278
Other Social Services	80,845	41,501	914,903	960,804	(45,901)	(4.8)	1,047,282
Tax Relief	1,612,601	133,768	4,657,699	4,704,181	(46,482)	(1.0)	1,838,567
School Facility Aid Program	-	-	20,733	18,118	2,615	14.4	25,736
Other Local Assistance	658,952	611,001	4,031,535	4,024,423	7,112	0.2	2,551,389
Energy Purchases	-	-	-	6,200,000	(6,200,000) (b)	(100.0)	-
Total Local Assistance	**5,020,821**	**3,400,154**	**58,092,522**	**66,070,287**	**(7,977,765)**	**(12.1)**	**47,885,824**

See notes on page 1.

(Continued)

SCHEDULE OF CASH DISBURSEMENTS (Continued)
(Amounts in thousands)

	Month of June		July 1 through June 30				
			2001				2000
	2001	2000	Actual	Estimate (a)	Actual Over or (Under) Estimate Amount	%	Actual
CAPITAL OUTLAY	**1,043,286**	**22,500**	**1,866,906**	**2,342,673**	**(475,767)**	**(20.3)**	**183,764**
NONGOVERNMENTAL (d)							
Transfer to Special Fund for Economic Uncertainties	-	-	-	-	-	-	353,550
Transfer to Other Funds	1,020,399	12,523	5,144,369	179,879	4,964,490 (b)	2,759.9	149,462
Transfer to Revolving Fund	(26,744)	(31,563)	38,361	-	38,361	-	20,293
Advance:							
State-County Property Tax Administration Program	(46,953)	(44,262)	(2,432)	-	(2,432)	-	(4,162)
Social Welfare Federal Fund	(30,187)	45,394	(82,703)	-	(82,703)	-	(21,079)
Tax Relief and Refund Account	(139,500)	(54,000)	-	-	-	-	-
Trial Court Trust Fund	-	-	-	-	-	-	(187,000)
Counties for Social Welfare	255,952	278,657	(22,705)	-	(22,705)	-	13,286
Total Nongovernmental	**1,032,967**	**206,749**	**5,074,890**	**179,879**	**4,895,011**	**2,721.3**	**324,350**
Total Disbursements	**$ 8,158,954**	**$ 5,289,619**	**$ 83,467,451**	**$ 86,522,205**	**$ (3,054,754)**	**(3.5)**	**$ 64,543,087**
TEMPORARY LOANS (d)							
Special Fund for Economic Uncertainties	$ -	$ -	$ -	$ -	$ -	-	$ -
Other Internal Sources	-	-	-	-	-	-	-
Revenue Anticipation Notes	-	(1,000,000)	-	-	-	-	-
Net Increase / (Decrease) Loans	**$ -**	**$ (1,000,000)**	**$ -**	**$ -**	**$ -**	**-**	**$ -**

See notes on page 1.

(Concluded)

COMPARATIVE STATEMENT OF REVENUES RECEIVED
All Governmental Cost Funds
(Amounts in thousands)

	July 1 through June 30			
	General Fund		Special Funds	
	2001	2000	2001	2000
MAJOR TAXES, LICENSES, AND INVESTMENT INCOME:				
Alcoholic Beverage Excise Taxes	$ 285,027	$ 282,869	$ -	$ -
Bank and Corporation Tax	6,546,270	6,575,403	20	36
Cigarette Tax	126,743	135,982	1,034,420	1,107,383
Estate, Inheritance, and Gift Tax	1,109,757	923,296	-	-
Horse Racing Fees	3,866	5,249	37,845	37,930
Insurance Companies Tax	1,501,455	1,300,771	-	-
Motor Vehicle Fuel Tax:				
Gasoline Tax	-	-	2,679,590	2,596,644
Diesel & Liquid Petroleum Gas	-	-	467,273	446,531
Jet Fuel Tax	-	-	2,746	2,372
Vehicle License Fees	-	-	3,344,360	3,335,399
Motor Vehicle Registration and Other Fees	-	-	2,010,165	1,974,289
Personal Income Tax	44,772,001	39,272,755	4,217	3,559
Retail Sales and Use Taxes	21,290,637	20,825,007	5,340,503	4,346,912
Pooled Money Investment Interest	836,686	362,264	257	408
Total Major Taxes, Licenses, and Investment Income	**76,472,442**	**69,683,596**	**14,921,396**	**13,851,463**
NOT OTHERWISE CLASSIFIED:				
Alcoholic Beverage License Fee	1,755	2,041	32,029	31,295
Electrical Energy Tax	-	-	232,678	218,972
Private Rail Car Tax	6,337	6,740	-	-
Penalties on Traffic Violations	-	-	89,172	90,026
Health Care Receipts	19,641	17,262	-	-
Revenues from State Lands	13,708	12,165	119,751	54,824
Abandoned Property	161,840	198,036	-	-
Trial Court Revenues	766	2,427	-	-
Miscellaneous	910,715	848,821	4,155,759	3,815,170
Not Otherwise Classified	**1,114,762**	**1,087,492**	**4,629,389**	**4,210,287**
Total Revenues, All Governmental Cost Funds	**$ 77,587,204**	**$ 70,771,088**	**$ 19,550,785**	**$ 18,061,750**

See notes on page 1.

STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS
A Comparison of Actual to 2000-01 Budget Act Estimates
(Amounts in thousands)
Attachment B

	July 1 through June 30				
	2001				2000
	Actual	Estimate (a)	Actual Over or (Under) Estimate: Amount	%	Actual
GENERAL FUND BEGINNING CASH BALANCE	**$ 8,531,322**	**$ 8,531,322**	**$ -**	**-**	**$ 847,936**
Add Receipts:					
Revenues	77,587,204	73,566,000	4,021,204	5.5	70,771,088
Nonrevenues	743,202	226,916	516,286	227.5	1,455,385
Total Receipts	78,330,406	73,792,916	4,537,490	6.1	72,226,473
Less Disbursements:					
State Operations	18,433,133	17,729,211	703,922 (b)	4.0	16,149,149
Local Assistance	58,092,522	61,313,973	(3,221,451)	(5.3)	47,885,824
Capital Outlay	1,866,906	2,393,340	(526,434)	(22.0)	183,764
Nongovernmental	5,074,890	1,125,407	3,949,483 (b)	350.9	324,350
Total Disbursements	83,467,451	82,561,931	905,520	1.1	64,543,087
Receipts Over / (Under) Disbursements	(5,137,045)	(8,769,015)	3,631,970	-	7,683,386
Net Increase / (Decrease) in Temporary Loans	-	237,693	(237,693)	(100.0)	-
GENERAL FUND ENDING CASH BALANCE	**3,394,277**	**-**	**3,394,277**	**-**	**8,531,322**
Special Fund for Economic Uncertainties (c)	204,486	1,543,807	(1,339,321)	(86.8)	816,081
TOTAL CASH	**$ 3,598,763**	**$ 1,543,807**	**$ 2,054,956**	**133.1**	**$ 9,347,403**
BORROWABLE RESOURCES					
Available Borrowable Resources	$ 12,342,385	$ 12,341,098	$ 1,287	-	$ 9,427,179
Outstanding Loans	-	237,693	(237,693)	(100.0)	-
Unused Borrowable Resources	$ 12,342,385	$ 12,103,405	$ 238,980	2.0	$ 9,427,179

General Note:
This report is based upon funded cash. Funded cash is cash reported to and recorded in the records of the State Controller's Office. Amounts reported as funded cash may differ from amounts in other reports to the extent there are timing differences in the recording of in-transit items.

Footnotes:
(a) A Statement of Estimated Cash Flow for the 2000-01 fiscal year prepared by the Department of Finance for the Budget Act of 2000. Any projections or estimates are set forth as such and not as representations of fact.
(b) These items contain transfers for energy purchases under the Governor's Emergency Proclamation. Those items with large overages are due to unanticipated purchases of energy, while items with underages reflect a smaller variance than truly exists. Recent activities not reflected in these figures include: (1) the Public Utilities Commission's decision to raise rates; (2) the delay in the sale of energy revenue bonds; (3) the Pacific Gas & Electric Company's bankruptcy; and (4) the recent agreement with Southern California Edison. All of these will have significant impacts on the General Fund in the future. To date, transfers from the General Fund for energy purchases totaled $5.9 billion.
(c) Includes the Disaster Response-Emergency Operations Account within the Special Fund for Economic Uncertainties.
(d) Negative balances are the result of repayments received that are greater than disbursements made.
(e) Excludes State School Building Bonds.

SCHEDULE OF CASH RECEIPTS
(Amounts in thousands)

	Month of June		July 1 through June 30				
			2001				2000
	2001	2000	Actual	Estimate (a)	Actual Over or (Under) Estimate Amount	%	Actual
REVENUES							
Alcoholic Beverage Excise Tax	$ 19,918	$ 24,249	$ 285,027	$ 287,000	$ (1,973)	(0.7)	$ 282,869
Bank and Corporation Tax	934,049	1,176,095	6,546,270	6,976,000	(429,730)	(6.2)	6,575,403
Cigarette Tax	11,265	14,666	126,743	132,000	(5,257)	(4.0)	135,982
Horse Racing Fees	1,601	3,679	3,866	-	3,866	-	5,249
Estate, Inheritance, and Gift Tax	78,370	78,373	1,109,757	1,003,000	106,757	10.6	923,296
Insurance Companies Tax	318,053	277,462	1,501,455	1,321,000	180,455	13.7	1,300,771
Personal Income Tax	3,651,320	3,944,920	44,772,001	40,981,000	3,791,001	9.3	39,272,755
Retail Sales and Use Taxes	1,734,402	2,050,843	21,290,637	21,194,000	96,637	0.5	20,825,007
Pooled Money Investment Interest	114,740	51,916	836,686	394,000	442,686	112.4	362,264
Not Otherwise Classified	60,493	(4,476)	1,114,762	1,278,000	(163,238)	(12.8)	1,087,492
Total Revenues	**6,924,211**	**7,617,727**	**77,587,204**	**73,566,000**	**4,021,204**	**5.5**	**70,771,088**
NONREVENUES							
Transfers from Special Fund for Economic Uncertainties	(64,085)	-	230,695	-	230,695	-	798,132
Transfers from Other Funds	21,858	25,586	171,463	(25,473)	196,936	-	338,986
Miscellaneous	30,609	18,219	341,044	252,389	88,655	35.1	318,267
Total Nonrevenues	**(11,618)**	**43,805**	**743,202**	**226,916**	**516,286**	**227.5**	**1,455,385**
Total Receipts	**$ 6,912,593**	**$ 7,661,532**	**$ 78,330,406**	**$ 73,792,916**	**$ 4,537,490**	**6.1**	**$ 72,226,473**

See notes on page 1.

SCHEDULE OF CASH DISBURSEMENTS
(Amounts in thousands)

	Month of June		July 1 through June 30				
			2001				2000
	2001	2000	Actual	Estimate (a)	Actual Over or (Under) Estimate Amount	%	Actual
STATE OPERATIONS (d)							
Legislative/Judicial/Executive	$ 57,144	$ 45,270	$ 1,047,188	$ 978,167	$ 69,021	7.1	$ 930,695
State and Consumer Services	55,755	30,947	465,333	448,472	16,861	3.8	427,136
Business, Transportation and Housing	48	665,141	43,963	35,554	8,409	23.7	672,394
Trade and Commerce	3,621	3,738	48,083	48,930	(847)	(1.7)	33,933
Resources	14,462	64,485	1,816,778	827,411	989,367 (b)	119.6	749,314
Environmental Protection Agency	(31,370)	14,303	318,920	327,675	(8,755)	(2.7)	140,350
Health and Human Services:							
Health Services	45,469	(4,267)	253,520	280,887	(27,367)	(9.7)	207,380
Mental Health Hospitals	37,782	26,478	455,378	451,564	3,814	0.8	368,949
Other Health and Human Services	(14,727)	55,605	366,087	395,791	(29,704)	(7.5)	342,249
Education:							
University of California	99,700	5,130	3,160,156	3,203,927	(43,771)	(1.4)	2,717,404
State Universities and Colleges	238,357	188,464	2,399,161	2,467,184	(68,023)	(2.8)	2,179,442
Other Education	12,582	9,988	171,491	177,228	(5,737)	(3.2)	152,414
Corrections and Youth Authority	363,692	342,863	4,595,721	4,403,914	191,807	4.4	4,242,264
General Government	56,003	83,102	1,047,796	1,395,924	(348,128)	(24.9)	772,964
Public Employees Retirement System	(9,539)	(4,838)	(28,114)	(19,590)	(8,524)	-	126,119
Debt Service (e)	132,901	100,241	2,265,419	2,289,244	(23,825)	(1.0)	2,033,501
Interest on Loans	-	33,566	6,253	16,929	(10,676)	(63.1)	52,641
Total State Operations	**1,061,880**	**1,660,216**	**18,433,133**	**17,729,211**	**703,922**	**4.0**	**16,149,149**
LOCAL ASSISTANCE (d)							
Public Schools - K-12	1,473,777	1,250,244	26,063,406	28,475,516	(2,412,110)	(8.5)	22,114,415
Community Colleges	212,157	198,072	2,743,161	2,770,153	(26,992)	(1.0)	2,293,579
Contributions to State Teachers' Retirement System	-	-	902,353	1,003,271	(100,918)	(10.1)	936,528
Other Education	(128,606)	164,035	1,922,204	2,010,285	(88,081)	(4.4)	1,846,123
Corrections and Youth Authority	11,497	8,141	117,227	291,298	(174,071)	(59.8)	108,929
Dept. of Alcohol and Drug Program	(240)	2,155	169,919	128,003	41,916	32.7	84,642
Dept. of Health Services:							
Medical Assistance Program	812,626	627,551	8,762,549	9,196,900	(434,351)	(4.7)	8,121,578
Other Health Services	56,957	20,949	442,550	459,866	(17,316)	(3.8)	338,076
Dept. of Developmental Services	68,529	2,222	946,779	980,772	(33,993)	(3.5)	814,917
Dept. of Mental Health	(84,654)	40,016	363,011	427,470	(64,459)	(15.1)	301,917
Dept. of Social Services:							
SSI/SSP/IHSS	145,143	230,131	3,277,035	3,409,527	(132,492)	(3.9)	3,102,868
CalWORKs	101,237	70,368	2,757,458	2,707,135	50,323	1.9	2,359,278
Other Social Services	80,845	41,501	914,903	925,828	(10,925)	(1.2)	1,047,282
Tax Relief	1,612,601	133,768	4,657,699	4,476,863	180,836	4.0	1,838,567
School Facility Aid Program	-	-	20,733	16,995	3,738	22.0	25,736
Other Local Assistance	658,952	611,001	4,031,535	4,034,091	(2,556)	(0.1)	2,551,389
Total Local Assistance	**5,020,821**	**3,400,154**	**58,092,522**	**61,313,973**	**(3,221,451)**	**(5.3)**	**47,885,824**

See notes on page 1.

(Continued)

SCHEDULE OF CASH DISBURSEMENTS (Continued)
(Amounts in thousands)

	Month of June		July 1 through June 30				2000
			2001				
					Actual Over or (Under) Estimate		
	2001	2000	Actual	Estimate (a)	Amount	%	Actual
CAPITAL OUTLAY	**1,043,286**	**22,500**	**1,866,906**	**2,393,340**	**(526,434)**	**(22.0)**	**183,764**
NONGOVERNMENTAL (d)							
Transfer to Special Fund for Economic Uncertainties	-	-	-	895,500	(895,500)	(100.0)	353,550
Transfer to Other Funds	1,020,399	12,523	5,144,369	229,907	4,914,462 (b)	2,137.6	149,462
Transfer to Revolving Fund	(26,744)	(31,563)	38,361	-	38,361	-	20,293
Advance:							
State-County Property Tax Administration Program	(46,953)	(44,262)	(2,432)	-	(2,432)	-	(4,162)
Social Welfare Federal Fund	(30,187)	45,394	(82,703)	-	(82,703)	-	(21,079)
Tax Relief and Refund Account	(139,500)	(54,000)	-	-	-	-	-
Trial Court Trust Fund	-	-	-	-	-	-	(187,000)
Counties for Social Welfare	255,952	278,657	(22,705)	-	(22,705)	-	13,286
Total Nongovernmental	**1,032,967**	**206,749**	**5,074,890**	**1,125,407**	**3,949,483**	**350.9**	**324,350**
Total Disbursements	**$ 8,158,954**	**$ 5,289,619**	**$ 83,467,451**	**$ 82,561,931**	**$ 905,520**	**1.1**	**$ 64,543,087**
TEMPORARY LOANS (d)							
Special Fund for Economic Uncertainties	$ -	$ -	$ -	$ 237,693	$ (237,693)	(100.0)	$ -
Other Internal Sources	-	-	-	-	-	-	-
Revenue Anticipation Notes	-	(1,000,000)	-	-	-	-	-
Net Increase / (Decrease) Loans	**$ -**	**$ (1,000,000)**	**$ -**	**$ 237,693**	**$ (237,693)**	**(100.0)**	**$ -**

See notes on page 1.

(Concluded)

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EXHIBIT 2

STATEMENT of GENERAL FUND CASH RECEIPTS and DISBURSEMENTS

October 2001

KATHLEEN CONNELL
California State Controller

KATHLEEN CONNELL
Controller of the State of California

November 9, 2001

Users of the Statement of General Fund Cash Receipts and Disbursements

Attached is the Statement of General Fund Cash Receipts and Disbursements for the period July 1, 2001 through October 31, 2001. This statement reflects the State of California's General Fund cash position and compare actual receipts and disbursements for the 2001-02 fiscal year to cash flow estimates prepared by the Department of Finance for the 2001-02 Budget Act. The statement is prepared in compliance with Government Code Section 12461.1, as well as Item 0840-001-0001, Provision 10, of the 2001-02 Budget Act, using records compiled by the State Controller.

These statements are also available on the Internet at the State Controller's homepage at **http://www.sco.ca.gov** under the category Statements of General Fund Cash Receipts and Disbursements.

Any questions concerning this report may be directed to Walter Barnes, Chief Deputy Controller, Finance at (916) 445-7447.

Sincerely,

KATHLEEN CONNELL
State Controller

MAILING ADDRESS P.O. Box 942850, Sacramento, CA 94250
SACRAMENTO 300 Capitol Mall, Suite 1850, Sacramento, CA 95814 (916) 445-2636
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STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS
A Comparison of Actual to 2001-02 Budget Act Estimates
(Amounts in thousands)

	July 1 through October 31				
	2001				2000
	Actual	Estimate (a)	Actual Over or (Under) Estimate Amount	%	Actual
GENERAL FUND BEGINNING CASH BALANCE	$ 3,394,277	$ 3,394,277	$ -	-	$ 8,531,322
Add Receipts:					
Revenues	19,083,992	19,775,952	(691,960)	(3.5)	20,613,951
Nonrevenues	1,055,289	1,075,586	(20,297)	(1.9)	209,206
Total Receipts	20,139,281	20,851,538	(712,257)	(3.4)	20,823,157
Less Disbursements:					
State Operations	7,430,438	7,370,765	59,673	0.8	6,183,234
Local Assistance	22,737,666	23,646,770	(909,104)	(3.8)	19,529,766
Capital Outlay	145,998	554,416	(408,418)	(73.7)	587,420
Nongovernmental	146,531	290,031	(143,500)	(49.5)	(109,000)
Total Disbursements	30,460,633	31,861,982	(1,401,349)	(4.4)	26,191,420
Receipts Over / (Under) Disbursements	(10,321,352)	(11,010,444)	689,092	-	(5,368,263)
Net Increase / (Decrease) in Temporary Loans	6,927,075	7,616,167	(689,092)	(9.0)	-
GENERAL FUND ENDING CASH BALANCE	-	-	-	-	3,163,059
Special Fund for Economic Uncertainties (b)	-	-	-	-	815,641
TOTAL CASH	$ -	$ -	$ -	-	$ 3,978,700

BORROWABLE RESOURCES					
Available Borrowable Resources	$ 17,558,570	$ 14,815,273	$ 2,743,297	18.5	$ 9,719,592
Outstanding Loans	6,927,075	7,616,167	(689,092)	(9.0)	-
Unused Borrowable Resources	$ 10,631,495	$ 7,199,106	$ 3,432,389	47.7	$ 9,719,592

General Note:
This report is based upon funded cash. Funded cash is cash reported to and recorded in the records of the State Controller's Office. Amounts reported as funded cash may differ from amounts in other reports to the extent there are timing differences in the recording of in-transit items.

Footnotes:
(a) A Statement of Estimated Cash Flow for the 2001-02 fiscal year prepared by the Department of Finance for the Budget Act of 2001. Any projections or estimates are set forth as such and not as representations of fact.
(b) Includes the Disaster Response-Emergency Operations Account within the Special Fund for Economic Uncertainties.
(c) Negative balances are the result of repayments received that are greater than disbursements made.
(d) Excludes State School Building Bonds.

SCHEDULE OF CASH RECEIPTS
(Amounts in thousands)

	Month of October		July 1 through October 31					
			2001				2000
	2001	2000	Actual	Estimate (a)	Actual Over or (Under) Estimate Amount	%	Actual
REVENUES							
Alcoholic Beverage Excise Tax	$ 22,679	$ 15,827	$ 104,245	$ 105,563	$ (1,318)	(1.2)	$ 92,117
Bank and Corporation Tax	252,326	292,143	1,524,382	1,765,387	(241,005)	(13.7)	2,110,982
Cigarette Tax	8,969	5,235	42,491	43,879	(1,388)	(3.2)	37,496
Horse Racing Fees	177	101	1,826	-	1,826	-	1,271
Estate, Inheritance, and Gift Tax	108,336	90,294	315,659	327,173	(11,514)	(3.5)	302,907
Insurance Companies Tax	11,963	8,271	360,298	356,504	3,794	1.1	330,903
Personal Income Tax	2,337,779	2,494,794	10,300,296	11,108,001	(807,705)	(7.3)	11,310,212
Retail Sales and Use Taxes	946,773	787,131	5,941,639	5,689,005	252,634	4.4	6,066,016
Pooled Money Investment Interest	-	105,740	163,637	158,111	5,526	3.5	254,765
Not Otherwise Classified	50,961	28,782	329,519	222,329	107,190	48.2	107,282
Total Revenues	**3,739,963**	**3,828,318**	**19,083,992**	**19,775,952**	**(691,960)**	**(3.5)**	**20,613,951**
NONREVENUES							
Transfers from Special Fund for Economic Uncertainties	-	440	-	-	-	-	440
Transfers from Other Funds	78,514	69,564	841,181	878,938	(37,757)	(4.3)	115,953
Transfers from Electric Power Fund	-	-	116,300	116,300	-	-	-
Miscellaneous	15,479	6,385	97,808	80,348	17,460	21.7	92,813
Total Nonrevenues	**93,993**	**76,389**	**1,055,289**	**1,075,586**	**(20,297)**	**(1.9)**	**209,206**
Total Receipts	**$ 3,833,956**	**$ 3,904,707**	**$ 20,139,281**	**$ 20,851,538**	**$ (712,257)**	**(3.4)**	**$ 20,823,157**

See notes on page 1.

SCHEDULE OF CASH DISBURSEMENTS
(Amounts in thousands)

	Month of October		July 1 through October 31				2000
			2001				
	2001	2000	Actual	Estimate (a)	Actual Over or (Under) Estimate Amount	%	Actual
STATE OPERATIONS (c)							
Legislative/Judicial/Executive	$ 121,224	$ 85,589	$ 490,024	$ 420,171	$ 69,853	16.6	$ 382,501
State and Consumer Services	33,066	39,398	152,008	152,247	(239)	(0.2)	153,959
Business, Transportation and Housing	(2,756)	(3,333)	10,823	12,480	(1,657)	(13.3)	7,236
Trade and Commerce	4,335	2,802	12,526	15,892	(3,366)	(21.2)	24,625
Resources	134,351	76,850	492,333	702,962	(210,629)	(30.0)	296,049
Environmental Protection Agency	17,290	17,063	200,964	283,216	(82,252)	(29.0)	52,896
Health and Human Services:							
Health Services	9,333	(7,016)	111,406	129,950	(18,544)	(14.3)	90,599
Mental Health Hospitals	66,067	51,380	191,717	190,999	718	0.4	168,861
Other Health and Human Services	77,754	21,058	285,841	214,477	71,364	33.3	155,863
Education:							
University of California	328,059	242,878	1,095,221	1,089,863	5,358	0.5	1,004,461
State Universities and Colleges	192,179	173,487	933,989	958,245	(24,256)	(2.5)	802,662
Other Education	24,478	21,961	92,065	95,751	(3,686)	(3.8)	72,414
Corrections and Youth Authority	478,318	392,874	1,744,798	1,345,057	399,741	29.7	1,543,584
General Government	75,735	68,963	405,601	483,791	(78,190)	(16.2)	403,318
Public Employees Retirement System	81,022	17,616	(12,680)	18,609	(31,289)	(168.1)	(9,189)
Debt Service (d)	411,657	514,744	1,223,802	1,257,055	(33,253)	(2.6)	1,031,724
Interest on Loans	-	1	-	-	-	-	1,671
Total State Operations	**2,052,112**	**1,716,315**	**7,430,438**	**7,370,765**	**59,673**	**0.8**	**6,183,234**
LOCAL ASSISTANCE							
Public Schools - K-12	3,253,870	2,231,320	9,160,927	9,593,957	(433,030)	(4.5)	7,859,969
Community Colleges	241,981	250,906	1,061,598	1,039,152	22,446	2.2	1,057,506
Contributions to State Teachers' Retirement System	96,187	138,886	679,399	679,399	-	-	725,500
Other Education	395,120	110,660	1,308,756	1,255,787	52,969	4.2	905,493
Corrections and Youth Authority	1,917	5,258	40,218	75,951	(35,733)	(47.0)	37,091
Dept. of Alcohol and Drug Program	35,257	4,963	174,946	151,287	23,659	15.6	35,254
Dept. of Health Services:							
Medical Assistance Program	852,622	645,857	3,327,807	3,696,234	(368,427)	(10.0)	2,665,259
Other Health Services	17,681	44,215	154,352	170,464	(16,112)	(9.5)	143,087
Dept. of Developmental Services	265,316	223,082	723,746	920,328	(196,582)	(21.4)	641,550
Dept. of Mental Health	234,943	9,818	342,415	188,396	154,019	81.8	36,457
Dept. of Social Services:							
SSI/SSP/IHSS	432,414	393,877	1,768,306	1,343,481	424,825	31.6	1,387,514
CalWORKs	326,373	358,968	1,589,849	1,291,539	298,310	23.1	1,582,161
Other Social Services	158,271	148,850	411,083	357,467	53,616	15.0	323,076
Tax Relief	244,029	168,599	752,921	932,023	(179,102)	(19.2)	851,345
School Facility Aid Program	-	-	-	10,910	(10,910)	(100.0)	-
Other Local Assistance	177,498	96,870	1,241,343	1,940,395	(699,052)	(36.0)	1,278,504
Total Local Assistance	**6,733,479**	**4,832,129**	**22,737,666**	**23,646,770**	**(909,104)**	**(3.8)**	**19,529,766**

See notes on page 1.

(Continued)

SCHEDULE OF CASH DISBURSEMENTS (Continued)
(Amounts in thousands)

	Month of October		July 1 through October 31				
			2001				2000
	2001	2000	Actual	Estimate (a)	Actual Over or (Under) Estimate Amount	%	Actual
CAPITAL OUTLAY	**39,294**	**407,775**	**145,998**	**554,416**	**(408,418)**	**(73.7)**	**587,420**
NONGOVERNMENTAL (c)							
Transfer to Special Fund for Economic Uncertainties	-	-	-	-	-	-	-
Transfer to Other Funds	251,511	19,214	272,769	307,784	(35,015)	(11.4)	64,771
Transfer to Revolving Fund	(32,903)	26,015	112,066	(3,005)	115,071	-	75,297
Advance:							
State-County Property Tax Administration Program	-	-	15,062	15,062	-	-	10,673
Social Welfare Federal Fund	6,664	(71,726)	2,586	22,490	(19,904)	(88.5)	17,016
Tax Relief and Refund Account	(4,400)	1,900	-	6,700	(6,700)	(100.0)	1,900
Counties for Social Welfare	-	-	(255,952)	(59,000)	(196,952)	-	(278,657
Total Nongovernmental	**220,872**	**(24,597)**	**146,531**	**290,031**	**(143,500)**	**(49.5)**	**(109,000**
Total Disbursements	**$ 9,045,757**	**$ 6,931,622**	**$ 30,460,633**	**$ 31,861,982**	**$ (1,401,349)**	**(4.4)**	**$ 26,191,420**
TEMPORARY LOANS							
Special Fund for Economic Uncertainties	$ (14,600)	$ -	$ 189,886	$ 204,486	$ (14,600)	(7.1)	$ -
Other Internal Sources	(473,599)	-	1,037,189	1,711,681	(674,492)	(39.4)	-
Revenue Anticipation Notes	5,700,000	-	5,700,000	5,700,000	-	-	-
Net Increase / (Decrease) Loans	**$ 5,211,801**	**$ -**	**$ 6,927,075**	**$ 7,616,167**	**$ (689,092)**	**(9.0)**	**$ -**

See notes on page 1.

(Concluded

COMPARATIVE STATEMENT OF REVENUES RECEIVED
All Governmental Cost Funds
(Amounts in thousands)

	July 1 through October 31			
	General Fund		Special Funds	
	2001	2000	2001	2000
MAJOR TAXES, LICENSES, AND INVESTMENT INCOME:				
Alcoholic Beverage Excise Taxes	$ 104,245	$ 92,117	$ -	$ -
Bank and Corporation Tax	1,524,382	2,110,982	4	20
Cigarette Tax	42,491	37,496	345,353	318,869
Estate, Inheritance, and Gift Tax	315,659	302,907	-	-
Horse Racing Fees	1,826	1,271	14,071	13,606
Insurance Companies Tax	360,298	330,903	572	-
Motor Vehicle Fuel Tax:				
Gasoline Tax	-	-	934,357	885,884
Diesel & Liquid Petroleum Gas	-	-	164,036	165,821
Jet Fuel Tax	-	-	668	808
Vehicle License Fees	-	-	709,752	1,103,355
Motor Vehicle Registration and Other Fees	-	-	640,895	647,029
Personal Income Tax	10,300,296	11,310,212	138	126
Retail Sales and Use Taxes	5,941,639	6,066,016	1,258,914	1,347,872
Pooled Money Investment Interest	163,637	254,765	371	98
Total Major Taxes, Licenses, and Investment Income	**18,754,473**	**20,506,669**	**4,069,131**	**4,483,488**
NOT OTHERWISE CLASSIFIED:				
Alcoholic Beverage License Fee	712	673	11,900	12,013
Electrical Energy Tax	-	-	60,432	54,329
Private Rail Car Tax	3	3	-	-
Penalties on Traffic Violations	-	-	22,433	23,283
Health Care Receipts	8,865	2,674	-	-
Revenues from State Lands	14,690	15,010	9,882	22,242
Abandoned Property	(5,252)	4,624	-	-
Trial Court Revenues	444	112	-	-
Miscellaneous	310,057	84,186	2,825,557	1,486,510
Not Otherwise Classified	**329,519**	**107,282**	**2,930,204**	**1,598,377**
Total Revenues, All Governmental Cost Funds	**$ 19,083,992**	**$ 20,613,951**	**$ 6,999,335**	**$ 6,081,865**

See notes on page 1.

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APPENDIX B

THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND

This APPENDIX B includes information about the Department, its Program, the 1943 Fund (including audited financial statements) and the Department's allocation of receipts from Contracts of Purchase, including Excess Revenues.

THE DEPARTMENT

General

In 1921, the California Legislature created the Veterans' Welfare Board and the Program. The Department of Veterans Affairs became the successor to the Veterans' Welfare Board under the Farm and Home Purchase Act of 1943. The Department is a subdivision of the State and constitutes a public corporation. One of the Department's basic objectives is to provide eligible veterans the opportunity to acquire homes with long-term low-interest financing provided under the Program.

The California Veterans Board ("Board") determines the policies for all operations of the Department. The Board is composed of seven members appointed by the Governor, subject to Senate confirmation, for respective terms of four years. All of the members of the Board must be veterans, one member must be retired from the active or reserve forces of the United States military service, one member must have substantial training or expertise in mortgage lending and real estate finance, one member must have substantial training or expertise in geriatrics, gerontology, or long-term care, and one member must be a resident of one of the California veterans homes run by the Department established for qualified aged and disabled veterans and their spouses.

There are four principal divisions within the Department: the Division of Veterans Services, the Division of Administration, the Veterans' Home Division and the Division of Farm and Home Purchases. The Program is administered by the Division of Farm and Home Purchases with support from the Division of Administration and other Department support units. See "THE PROGRAM."

The Office of Inspector General for Veterans Affairs was created by statute in 1999, and in 2000 the Governor appointed and the Senate confirmed the appointment of an Inspector General for Veterans Affairs. The Inspector General is subject to the direction of the Governor, and is to provide ongoing and independent advice to the Board regarding any issue under Board consideration. The Inspector General is responsible for reviewing and reporting on the operations and financial condition of all veterans programs supported by the State, which include the Program. The Inspector General is required to submit an annual report to the Board and to the State Legislature, which is to include any recommendations for improving the operations of veterans programs, including the Program.

Administration

In addition to its headquarters in Sacramento, the Division of Farm and Home Purchases maintains field offices located throughout the State. These local offices, in addition to providing information to all veterans concerning the Program, are responsible for Contract of Purchase originations and the initial collection and evaluation of data regarding applicants for the Program and the properties to be acquired under the Program. This includes examinations as to the qualification of veterans to participate in the Program, a credit analysis for each applicant, appraisals of properties and the initial processing of the veterans' applications for Contracts of Purchase.

Final processing and servicing of the Contracts of Purchase are performed by the Department at its headquarters and entail Contract of Purchase accounting, insurance and property damage claims adjustment and services, Contract of Purchase alterations and contract performance services. The Department allows mortgage brokers to originate Contracts of Purchase. All Contracts of Purchase are serviced by the Department. Effective July 1, 1999 the Department began utilizing its new Integrated Loan Processing and Financial Information System for origination and servicing of all new Contracts of Purchase. General administration of the Program, including fiscal, legal, personnel and other administrative functions, is also performed at the Department's headquarters. As of September 30, 2001, the Department had a staff of approximately 234 persons in support of the Program.

The Secretary and other staff personnel of the Department principally responsible for the administration of the Program are listed below. The Secretary is appointed by the Governor of the State, serves at the pleasure of the Governor, and must be a veteran.

Bruce Thiesen
Secretary of Veterans Affairs since November 2001

Secretary Thiesen is a Vietnam-era Army veteran with a long history as a veterans' activist. In January 1999, Mr. Thiesen was appointed Deputy Secretary for Operations of the Department, and was appointed Interim Secretary of Veterans Affairs in May 2000. Mr. Thiesen has more than 30 years of broad experience as an independent agribusinessman in farm management, farm labor acquisition and benefits administration. Mr. Thiesen served as National Commander of the American Legion in 1993-1994 and from 1995 through 1998 he was appointed by the Secretary of the United States Department of Veterans Affairs as a member of the Veterans Advisory Committee on Rehabilitation. In addition to his work on behalf of veterans, Mr. Thiesen is involved in a number of other community and philanthropic efforts.

Gerald Rucker
Undersecretary since December 1999

Mr. Rucker brings a 30-year history of California State management to the Department. Recent experience includes eight years as Chief of Veterans Services Division and State Service Officer for the Department. From May 1999 to December 1999 Mr. Rucker served as Senior Assistant to the Secretary of the Department. Prior to joining the Department management team in 1991, he held a variety of management posts with the Departments of Social Services and

Rehabilitation. These positions included Personnel Management and Loma Prieta Earthquake Disaster Recovery Team manager, as well as assignments with fiscal information technology and systems development responsibility. Mr. Rucker is a service-connected disabled veteran who served with the 1st Cavalry Division in Vietnam, including combat action during the TET Offensive of 1968, and is a member of the Veterans of Foreign Wars and Disabled American Veterans.

Sheryl A. Schmidt
Deputy Secretary since November 1996

After leaving the accounting firm of Touche Ross (now known as Deloitte & Touche LLP) in 1987, Deputy Secretary Schmidt began her state career at the State Controller's Office as a Certified Public Accountant (CPA). In 1995, she accepted the newly created position of Chief of Audits at the Department and developed the Internal Audit Division. In 1996, the Governor of California appointed United States Air Force veteran Sheryl Schmidt as the Deputy Secretary of Women Veterans Affairs. Ms. Schmidt also provides administrative oversight over the Information Systems Division and Business Services. Ms. Schmidt holds a Bachelor's degree in management from St. Leo's College in Florida, a Master's of Business Administration (MBA) from California State University, Sacramento, and a CPA license from the California State Board of Accountancy.

John M. Hanretty
Chief, Financial Services Division since October 1999

Mr. Hanretty is a United States Air Force, Vietnam-era veteran who graduated from California State University, Sacramento in 1975 with a degree in Government. After graduation, he worked for eight years in the California Department of Health Services regulating Prepaid Health Plans for Medicaid clients. He then spent twelve years in management positions with private health maintenance organizations in Arizona and California rising to the level of Chief Executive Officer. His responsibilities included sales, medical management, provider staffing, member services, contracting, financial accounting and budgeting. He returned to State government service in 1994 as a Budget Manager. Mr. Hanretty served as the Budget Officer for the Department from August 1998 until December 1999 and was appointed Chief, Financial Services Division in September 1999. He has continuously served on community non-profit boards of directors during his professional career.

George Flores
Chief, Farm and Home Purchases Division since May 1999

Mr. Flores has been with the Department for 24 years. He has served as Manager of the Title and Escrow Unit, Headquarters Operation Manager, Southern Regional Manager and the Assistant Division Chief. He has held the position of Farm and Home Division Chief for two years. He is a United States Army veteran who was graduated from California State University, Sacramento, in 1973 with a Bachelor's of Science degree in Business Administration, and he attended the McGeorge School of Law, University of the Pacific, Sacramento.

Kandis L. Mendonsa
Chief, Bond Finance Division since May 1998

Ms. Mendonsa brings to her current position more than a quarter century of service in California State government. For most of that time, she has worked exclusively in the area of financial management. Prior to joining the Department in 1998, Ms. Mendonsa was employed for 10 years by the Department of Social Services and for 12 years at the State Department of Corrections. While at Corrections, among Ms. Mendonsa's responsibilities was the management of a $4 billion tax exempt bond program for the construction of youth and adult correction facilities.

Joseph Maguire
Deputy Secretary/Chief Counsel of Legal Affairs since January 2001

Mr. Maguire received a bachelor's degree in business administration from American University in Washington, D.C. in 1967. He then served two years in the U.S. Army. After leaving the military, he worked in the private sector for several years as a franchise business consultant. He then taught mathematics and science in the Philadelphia Public School System while earning a master's degree in education at Temple University in Philadelphia, Pa. In 1976, Mr. Maguire began attending McGeorge School of Law while teaching science and mathematics at Sacramento Country Day School in Sacramento. After graduating in 1980, Mr. Maguire practiced business law for one year as an associate with a private law firm. Mr. Maguire then became a supervisor and senior trial prosecutor. In January 2001, Governor Davis appointed Mr. Maguire to the position of Deputy Secretary/Chief Counsel for Legal Affairs of the Department.

THE PROGRAM

General

The Department began making low interest rate farm and home financing available to veterans after World War I, following the enactment by the California Legislature (the "Legislature") of the Veterans Farm and Home Purchase Act of 1921. In 1943, the Legislature enacted the Veterans Farm and Home Purchase Act of 1943 ("1943 Act") which modified the Program to meet new needs of veterans. The 1943 Act was superseded by the Veterans Farm and Home Purchase Act of 1974 ("1974 Act") which again modified the Program. The 1943 Act established the 1943 Fund in the State Treasury, which is the principal fund utilized by the Program.

Since its inception, the Program has assisted over 411,900 veterans to purchase farms and homes throughout the State through long-term housing and farm loans. The sales of revenue bonds (including Revenue Bonds) and Veterans G.O. Bonds, combined with surplus revenues under the Program not needed at any given time to meet the then-current bond retirement schedules and operating costs, have financed the purchase of farms and homes since Program inception. As of September 30, 2001, there were 31,256 Contracts of Purchase outstanding with a remaining principal balance of $2,561,288,000. As of September 30, 2001, the Department had approximately 266 pending applications for Contracts of Purchase in the approximate total principal amount of $40,000,000. See EXHIBIT 2 to this APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Existing Contracts of Purchase" and "– Amounts Expected to be Available to Finance Contracts of Purchase and Related Investments" for information regarding existing Contracts of Purchase and moneys available to finance additional Contracts of Purchase.

The description of the Program under this heading is a description of the Program as it currently exists under the Veterans Code and the Department's implementation thereof. The Veterans Code and the Department's implementation of the Program are subject to change. The Program is also subject to the Federal Tax Code, as noted below.

Qualifying Veteran Status

Veterans Code. A veteran must meet qualifications established under State law in the Veterans Code in order to participate in the Program. The qualifications specified in the Veterans Code are subject to change by the Legislature. The Veterans Code currently requires, generally, that a veteran must have served at least ninety days on active duty in the Armed Forces of the United States, unless sooner discharged because of a service-connected disability, or as a member of the National Guard or reserves called to active duty by Presidential order, and must have received an honorable discharge or been released from active duty under honorable conditions. The Veterans Code allows the Department to finance Contracts of Purchase for:

(a) veterans who have served during one of the following periods:

(i) April 6, 1917 through November 11, 1918; December 7, 1941 through December 31, 1946; or June 27, 1950 through January 31, 1955 (such veterans are referred to as "Earlier War Veterans");

(ii) February 28, 1961 through August 4, 1964 if the veteran served in the Republic of Vietnam during that period ("Early Vietnam Veterans"); or August 5, 1964 through May 7, 1975 (all veterans referred to in this clause (ii) are "Vietnam Era Veterans"); or

(iii) on or after August 2, 1990, through a date as yet to be determined by the President of the United States; at any time in Somalia, or in direct support of the troops in Somalia, during Operation Restore Hope; or at any time in an expedition or campaign for which a medal was authorized by the United States Government such as the Armed Forces Expeditionary and Vietnam Service Medals (such veterans are referred to as "Recent War Veterans"); and

(b) any person who qualifies under the Federal Tax Code for financing from Revenue Bonds or unrestricted funds of the Department and who served in the active military, naval, or air service for a period of not less than 90 consecutive days and who received an honorable discharge or was released from active duty under honorable conditions (such veterans are referred to as "Peacetime Veterans").

Amendments to the Veterans Code effective January 1, 1998 added Early Vietnam Veterans and Peacetime Veterans as veterans eligible to receive Contracts of Purchase. These amendments, together with various financial and programmatic changes implemented by the Department, have significantly increased the universe of potential eligible veterans. See EXHIBIT 2 to this APPENDIX B - "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA."

Federal Tax Code. In order to determine which Department moneys can be used to finance Contracts of Purchase, the Department must also take into account the requirements of Federal law set forth in the Federal Tax Code, which limits the universe of veterans eligible to receive Contracts of Purchase financed from certain sources. See APPENDIX E - "CERTAIN FEDERAL TAX CODE REQUIREMENTS." Applying the current Federal Tax Code separates the Department's lendable moneys into three classes:

(a) "Unrestricted Moneys" (derived from certain moneys in the 1943 Fund, certain proceeds of pre-Ullman (as defined below) Revenue Bonds and Veterans G.O. Bonds, and certain future issues of taxable bonds, if any), which can finance Contracts of Purchase for those veterans who qualify under the applicable provisions of the Veterans Code (the QMB Loan Eligibility Requirements (defined below) do not apply to Contracts of Purchase financed by Unrestricted Moneys). The Department has implemented a policy (which is subject to change) to make Unrestricted Moneys available for Earlier War Veterans, Vietnam Era Veterans, and Recent War Veterans. ("Pre-Ullman" refers to the period prior to enactment of Federal Tax Code programmatic restrictions on the use of proceeds of tax-exempt bonds to finance mortgage loans.);

(b) "Qualified Veterans Mortgage Bond Proceeds" (derived exclusively from proceeds of Veterans G.O. Bonds) which can finance Contracts of Purchase for any veteran who (i) qualifies under the Veterans Code, (ii) served on active duty prior to January 1, 1977, and (iii) was released from active duty fewer than 30 years before receiving such financing. The last date of veteran eligibility under clause (iii) is December 31, 2036 for a veteran with 30 years of continuous service after December 31, 1976. (The QMB Loan Eligibility Requirements (defined below) do not apply to Contracts of Purchase financed by moneys derived exclusively from proceeds of Veterans G.O. Bonds.) These proceeds can finance Contracts of Purchase for Earlier War Veterans and Vietnam Era Veterans; and

(c) "Qualified Mortgage Bond Proceeds" (which are principally derived from Revenue Bond proceeds other than pre-Ullman Revenue Bond proceeds), can finance Contracts of Purchase for any veteran who (i) qualifies under the Veterans Code, and (ii) satisfies certain requirements imposed by the Federal Tax Code principally limiting the family income of applicants and the property purchase price, and, subject to certain exceptions, requiring that the veteran not have had a present ownership interest in his principal residence in the three years prior to obtaining such financing ("QMB Loan Eligibility Requirements").

Allocation of Lendable Moneys

For veterans who qualify for Contracts of Purchase from two or more of the above-described financing sources, the Department may select the source of funds to be used in its sole discretion. The Department's goal is to maximize the availability of Program benefits. Current policy is that (a) only those veterans who qualify only for Unrestricted Moneys (such as the Winter 2002 Revenue Bonds) will be funded from that source; and (b) veterans who qualify for both Qualified Mortgage Bonds Proceeds and Qualified Veterans Mortgage Bond Proceeds (such as the Offered Veterans G.O. Bonds) are allowed to select between the two funding sources.

Administration of the Farm and Home Purchase Program

The Department finances new and existing single-family homes, farms and mobile homes located in the State by acquiring the property selected by a veteran under a Contract of Purchase. The Department also finances home improvements with respect to properties covered by existing Contracts of Purchase, subject to applicable restrictions of the Federal Tax Code. A Contract of Purchase creates an installment land sale contract between the Department and the veteran which is somewhat analogous to a loan from the Department to the veteran. The amount which the Department finances is reflected in the Contract of Purchase as the "purchase price." See "THE PROGRAM – CONTRACTS OF PURCHASE" in this APPENDIX B.

At present under the Veterans Code, the maximum purchase price to the Department of an existing home or the sum to be expended by the Department pursuant to a Contract of Purchase for a home to be constructed is $250,000 and for farms is $300,000 (*except* that the limitation with respect to mobile homes located on or to be located on a leased or rented site in a mobile home park is $70,000 and *except* that the maximum purchase price for any home may be increased by an additional $5,000 for certain purposes). The Legislature has periodically made changes in the maximum amount that may be financed under a Contract of Purchase. The Federal Tax Code imposes maximum purchase prices on properties which are the subject of Contracts of Purchase financed by Qualified Mortgage Bond Proceeds. The Federal Tax Code permits such maximums to be adjusted periodically. (No Federal Tax Code purchase price limits apply to Contracts of Purchase financed from Unrestricted Moneys or Qualified Veterans Mortgage Bond Proceeds.) These Federal Tax Code requirements vary depending upon where the property is located, if it is in a targeted or non-targeted area, and whether it is a new or existing home. The maximum purchase price under the Program is, therefore, the Veterans Code maximum amount or, if the Contract of Purchase is being financed by Qualified Mortgage Bond Proceeds, the lesser of the Veterans Code maximum amount or the maximum amount under applicable provisions of the Federal Tax Code.

Although the Veterans Code does not impose maximum income limits, the Federal Tax Code imposes maximum income limits applicable only to veterans obtaining Contracts of Purchase financed by Qualified Mortgage Bond Proceeds. The income limits vary by statistical area and family size. No maximum income limits apply to veterans obtaining Contracts of Purchase financed by Unrestricted Moneys or Qualified Veterans Mortgage Bond Proceeds.

Any veteran who qualifies under the Veterans Code and the Federal Tax Code may be granted a subsequent Contract of Purchase so long as any previous Contract of Purchase has been paid in full or the veteran lost his interest in the previous Contract of Purchase through divorce or dissolution of marriage.

Contracts of Purchase

General. Pursuant to the Program, the Department and the veteran enter into a Contract of Purchase for a farm, home or mobile home. Under a Contract of Purchase, the veteran has the benefits of ownership as the equitable owner, but title to the property and improvements is held by the Department as the legal owner until the final principal payment is made. Property sold under a Contract of Purchase may not be transferred, assigned, encumbered, leased, let or sublet without the written consent of the Department. Any permitted encumbrance must be junior or secondary to the Department's interest in the property.

Before 1998, Contracts of Purchase were not insured or guaranteed by the Federal Housing Administration, the United States Department of Veterans Affairs (the "USDVA"), Rural Development (formerly Farmers' Home Administration), or any private primary mortgage insurer. In 1998, the Department was approved by the USDVA as an originator of loans eligible to receive a guaranty from the USDVA. In addition to the USDVA guaranty, the Department has secured primary mortgage insurance for certain prior and all future Contracts of Purchase not guaranteed by the USDVA with loan-to-value ratios ("LTV") above 80% from Radian Guaranty Inc. ("Radian"). See "THE PROGRAM – Loan Insurance – Primary Mortgage Insurance." Certain Contracts of Purchase are not the subject of loan insurance or guarantees. See EXHIBIT 2 to this APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Existing Contracts of Purchase."

The terms of the Contracts of Purchase are substantially identical, except for interest rates on Contracts of Purchase originated after January 1, 1999, regardless of whether they are funded by Unrestricted Moneys, Qualified Veterans Mortgage Bond Proceeds or Qualified Mortgage Bond Proceeds, except for Federal Tax Code-mandated differences in Contracts of Purchase financed with Qualified Mortgage Bond Proceeds. Two ways in which such Contracts of Purchase are different are: (a) Contracts of Purchase financed by Qualified Mortgage Bond Proceeds have more restrictions on the right of a purchaser to assume the obligations under the Contract of Purchase than do Contracts of Purchase financed by Unrestricted Moneys or Qualified Veterans Mortgage Bond Proceeds; and (b) certain Contracts of Purchase financed by Qualified Mortgage Bond Proceeds are subject to Federal Tax Code-mandated recapture provisions. In addition, the Federal Tax Code contains the QMB Loan Eligibility Requirements, which are numerous loan eligibility restrictions on borrowers receiving financing from proceeds such as Qualified Mortgage Bond Proceeds. These restrictions require, among other things, and subject to certain exceptions contained in the Federal Tax Code, that borrowers (i) not have had a present ownership interest in their principal residence during the three-year period preceding the date of financing, (ii) are eligible to finance the purchase of residences with purchase prices not in excess of limits stated in the Federal Tax Code, (iii) must not have family incomes in excess of limits stated in the Federal Tax Code, (iv) may not use the proceeds of the financing to refinance an existing mortgage loan, and (v) may use the proceeds of the financing only to finance one-family or one-to-four family dwelling units meeting certain criteria. The Federal Tax Code includes certain procedures that an issuer of Qualified Mortgage Bonds may undertake to satisfy these requirements, but requires that 95% or more of the proceeds of the bond issue be used in full compliance with the loan eligibility restrictions.

Since the number and aggregate principal balance of Contracts of Purchase relating to farms and mobile homes and Contracts of Purchase financed pursuant to the 1943 Act are statistically insignificant, the discussion below is limited to Contracts of Purchase financed under the 1974 Act for homes, excluding farms and mobile homes in rental parks, unless otherwise indicated. See EXHIBIT 2 to this APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Existing Contracts of Purchase."

Many factors affect the ability or willingness of homebuyers to make mortgage loan payments and of potential homebuyers to borrow money to purchase homes. These factors include, among others, general economic conditions, interest rates, and costs of living.

Origination. The Veterans Code, in most cases, requires the veteran to make an initial payment of at least 2% of either the purchase price or the market value of the property, whichever is less. In the case of veterans who are ineligible for a full USDVA guaranty, Department policy requires the veteran to make an initial payment of 3% of either the purchase price or the market value of the property, whichever is less. The balance of the purchase price, including USDVA guaranty fees, may be amortized over a period fixed by the Department, not exceeding 30 years and 32 days for all Contracts of Purchase guaranteed by USDVA, and 40 years for any other Contracts of Purchase. Pursuant to its policy, the Department issues all new Contracts of Purchase for terms of 30 years unless a shorter term is requested. Existing contracts are occasionally extended beyond 30 years in cases of extreme financial hardship.

In addition to the initial payment referred to in the prior paragraph, a Loan Origination Fee ("LOF") of 1% of the loan amount is collected at close of escrow on all contracts issued after January 1, 1999. This fee must be paid in escrow by the buyer or seller. If the loan application is submitted through an approved mortgage broker, the 1% fee is paid directly to the mortgage broker through the escrow. Otherwise, the fee is retained by the Department. While the Department's field offices will continue to originate Contracts of Purchase, the Department expects the bulk of the Contracts of Purchase to be originated by mortgage brokers. After a preliminary screening in the field offices, applications will be forwarded to a centralized underwriting unit in Sacramento for processing. The mortgage brokers deal directly with the central underwriting, escrow and administrative staff in Sacramento. An appraisal fee of $300 to $425 is collected from the applicant and is paid directly to the appraiser upon completion of the assignment. In rare cases, where the appraisal is performed by a Department employee, the fee is retained by the Department.

The Veterans Code permits the Department to finance permanent home and property improvements for veterans with existing Contracts of Purchase. When a home improvement loan is approved, total financing, including the balance of the original loan, the amount of the improvement loan, and any other encumbrances, cannot exceed 90% of the improved market value of the property. Typically this total LTV ratio is much lower than 90%. Improvement loans are not approved for veterans who have had significant delinquencies in the 12 months immediately preceding the application. Funds are disbursed by the Department directly to the contractors (or vendors) as the improvements are completed. A separate Contract of Purchase covering only the improvements is executed, bearing interest at the same rate as the veteran's existing Contract of Purchase. The new Contract of Purchase is payable over a term up to 15 years based on the amount of the Contract of Purchase. In no event can the term, from the inception of the original Contract of Purchase through the pay-off of the improvement Contract of Purchase, exceed 40 years. A LOF of 1.5% of the improvement Contract of Purchase amount is charged. The maximum home improvement loan for veterans funded with Qualified Mortgage Bond Proceeds is $15,000 over the term of the original Contract of Purchase. Home improvement loans funded with Unrestricted Moneys or Qualified Veterans Mortgage Bond Proceeds are available up to a maximum of $50,000. Subsequent home improvement Contracts of Purchase may be granted, if funds are available, so long as there is only one home improvement Contract of Purchase to any veteran outstanding at any time. Currently, less than one percent of the total principal balance of all Contracts of Purchase is derived from home improvement loans.

Contracts of Purchase for the purchase of a building site and construction of a home are available. Qualifying sites include undeveloped sites/acreage, lots in subdivision developments, and sites in non-profit self-help developments. Mobile homes in parks do not qualify. Construction of the improvements must be performed by a licensed California contractor. The Department does not submit Contracts of Purchase which finance home construction for USDVA guaranty.

The Department also limits availability of financing to veterans on the basis of their personal credit status. The Department's current lending criteria conform to those of the USDVA for participation in the USDVA guaranty program for all Contracts of Purchase, including those not eligible for USDVA guarantees. Department procedures are consistent with those established by USDVA for its loan guaranty program.

The history of the Department's originations of Contracts of Purchase is set forth in EXHIBIT 2 to this APPENDIX B - "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA - Contracts of Purchase - Contracts of Purchase Origination and Principal Repayment Experience."

Servicing. All Contracts of Purchase are serviced by the Department. Late penalty charges are applied to Contracts of Purchase that have a remaining amount due of $25 or more at the close of any account month. A $10 late penalty charge is imposed on Contracts of Purchase originated before October 1984. Contracts of Purchase originated during and after October 1984 are subject to a late penalty charge of 4% of the principal and interest portion of the installment, consistent with penalties authorized by USDVA.

The Department may, in any individual case and for good cause, permit the postponement from time to time, and upon such terms as it deems proper, of the payment of the whole or any part of any installment. Contracts of Purchase may also have terms in excess of 30 years if home improvement loans have been obtained, as discussed above. The terms of Contracts of Purchase guaranteed by USDVA, however, cannot exceed 30 years and 32 days.

Prepayment Penalties. There are no prepayment penalties on any Contracts of Purchase.

Cancellations and Delinquencies. The Department's policies regarding delinquencies and cancellations conform to USDVA loan guaranty program requirements and the requirements of

Radian. In the event of a failure to comply with any of the terms of a Contract of Purchase, the Department may cancel the Contract of Purchase and be released from all obligations, at law or in equity, to convey the property. In such event, the veteran's rights under the Contract of Purchase may be forfeited and all payments made by the veteran prior to termination of the Contract of Purchase deemed to be rental paid for occupancy. Upon such forfeiture, the Department takes possession of the property covered by the Contract of Purchase and resells it.

If a veteran does not make a payment by the close of the account month in which the payment is due (usually the 18th day of the month), the payment is considered "delinquent." A warning letter is issued on the 20th day of the same account month which advises the veteran that the account is delinquent. Department personnel initiate telephone contact with veterans with delinquent accounts. If the account remains delinquent through the second account month, a Notice of Intent to Cancel Contract is issued at the beginning of the third account month giving notice that the Contract of Purchase may be canceled at the end of the 30-day notice period unless the account is brought current. A schedule for liquidation of delinquent payments satisfactory to the Department is arranged during this period; *however,* if the account remains delinquent after such 30-day period and no schedule for liquidation of delinquent payments has been agreed upon, the Department may begin cancellation of the Contract of Purchase. If a schedule of liquidation has been agreed to with respect to a Contract of Purchase and the veteran makes all regularly scheduled payments and liquidation payments on a timely basis, the Contract of Purchase is not considered delinquent.

The Department's headquarters Central Collections Unit monitors the delinquency throughout this process, orders a title search to identify any junior lienholders and forwards the pertinent information to the Department's Foreclosure Unit for further precancellation processing in accordance with the California Code of Regulations, Title 12, Section 344, Military and Veterans Affairs. Junior lienholders are identified and sent notices giving them 30 days (40 days in the case of Federal tax liens) to protect their interest by beginning foreclosure proceedings. If the account is not brought current during such notice period to junior lienholders and no junior lienholder proceeds with a foreclosure action to protect its interest, the Department's Foreclosure Unit cancels the contract, and a Notice of Cancellation is mailed to the veteran and recorded. The Department's Foreclosure Unit then takes steps to evict occupants and clear any remaining liens. If judicial action is required, the case is referred to the Department's Law Division for additional processing.

After all remaining liens are removed and the property is vacant, the repossessed property is repaired and improved, if necessary, and is marketed through the Department's centralized repossession sales unit. The Department is required to advertise and accept sealed offers after a 2-week period, and the property is sold to the highest acceptable bidder. If no acceptable bids are received, the property is sold through a real estate broker and a commission of between 3% to 6% of the selling price is paid.

Federal law provides certain protections to military personnel on active duty or reservists ordered to report for military service under The Soldiers' and Sailors' Civil Relief Act of 1940, as amended (the "Soldier's and Sailor's Relief Act"). Under the Soldier's and Sailor's Relief Act, the veteran may seek a stay (or a court may on its own motion grant a stay) of any court action or proceeding. The Department does not know how many of the veterans who have received Contracts of Purchase qualify or could qualify for such relief and, therefore, cannot predict the financial impact of such relief on the 1943 Fund.

See EXHIBIT 2 to this APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – CONTRACTS OF PURCHASE – Cancellations and Delinquencies" for additional information regarding the status of Contracts of Purchase.

Interest Rates. Contracts of Purchase originated prior to January 1, 1999 bear interest at a rate which is set by the Department and may be changed with the approval of the Board and the Veterans' Finance Committee of 1943 (the "Finance Committee"). Most of such Contracts of Purchase currently bear interest at a rate of 6.95%. The Veterans Code currently requires that, generally, all Contracts of Purchase originated prior to January 1, 1999 (the "pre-1999 Contracts of Purchase") bear the same interest rate. In accordance with the current provisions of the Veterans Code, the interest rate for such pre-1999 Contracts of Purchase can be changed annually as deemed necessary. The effective date of a higher rate of interest on pre-1999 Contracts of Purchase may occur only once in any calendar year unless a finding is made by the Board and the Finance Committee that such additional action is necessary to protect the solvency of the 1943 Fund.

Legislation passed in 1998 (i) eliminated the uniform interest rates requirement for Contracts of Purchase originated on or after January 1, 1999; (ii) allows the Department to establish non-uniform fixed or variable interest rates for such Contracts of Purchase; and (iii) allows the Department to modify such interest rates, or the methodology and timing for determining or modifying interest rates, from time to time, subject to the approval of the Board and the Finance Committee. The Department received approval to implement a flexible mechanism to provide for periodic adjustments of the interest rate on new Contracts of Purchase funded from Qualified Mortgage Bond Proceeds, Qualified Veterans Mortgage Bond Proceeds, and Unrestricted Moneys. As a result of such mechanism, interest rates for new Contracts of Purchase funded on and after September 1, 2001 are currently 6.00% for Contracts of Purchase financed using Qualified Mortgage Bond Proceeds, 6.25% for Contracts of Purchase financed using Qualified Veterans Mortgage Bond Proceeds (such as the Offered Veterans G.O. Bonds), and 6.50% for Contracts of Purchase using Unrestricted Moneys (such as the Winter 2002 Revenue Bonds). Interest rates on Contracts of Purchase are expected to be established in the future based on various factors deemed appropriate by the Department, subject in all cases to the requirements of the resolution authorizing the issuance of Revenue Bonds (the "Revenue Bond Resolution") for the filing of Cash Flow Statements and conformance with Program Operating Procedures. As noted herein, the Program Operating Procedures are operating policies of the Department governing the discretionary activities of the Department under the Revenue Bond Resolution. The Cash Flow Statement consists of the conclusion by an authorized representative of the Department that projected revenues will be sufficient to provide for timely payment of principal of and interest on the Revenue Bonds and expenses, under each scenario included in the quantitative analysis which accompanies the Cash Flow Statement. See EXHIBIT 2 to this APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA –

Contracts of Purchase – Selected Principal Flows with respect to Contracts of Purchase funded by both Veterans G.O. Bonds and Revenue Bonds."

Federal law provides certain protections to military personnel on active duty or reservists ordered to report for military service under The Soldiers' and Sailors' Relief Act. If a veteran obtained a Contract of Purchase prior to the relevant period of military service, then during the period of military service the interest rate on the Contract of Purchase cannot exceed 6% (unless the ability of the veteran to pay interest in excess of 6% is not materially impaired by such military service). The Department does not know how many of the veterans who have received Contracts of Purchase qualify or could qualify for such relief and, therefore, cannot predict the financial impact of such relief on the 1943 Fund.

Loan Insurance

Since 1997, the Department has completed several programmatic changes, including obtaining loan insurance from a private primary mortgage insurer for certain existing Contracts of Purchase with high LTVs, and USDVA guarantees or private primary mortgage insurance for all new Contracts of Purchase (except mobile homes in parks, construction loans during the construction period, and home improvement loans) with LTVs above 80% up to 100%. In addition to the LOF and initial payment, the Department collects a funding fee of from 1.25% up to 3% of the Contract of Purchase amount, based on the LTV for each Contract of Purchase which exceeds an LTV of 80%. The fee may be paid in escrow by the buyer or seller, or it may be added to the base loan amount. Veterans described above who are ineligible for a full USDVA guaranty and therefore are obligated to make an initial 3% payment must advance a funding fee of up to 2% of the base loan amount to the Department at close of escrow, and the funding fee may not be added to the base loan amount. With respect to eligible Contracts of Purchase, this fee is paid to the USDVA for the cost of the loan guaranty. If the veteran or the property is not eligible for a USDVA loan guaranty, the funding fee is retained by the Department, and a portion of such funding fees is used by the Department to pay costs related to the Radian primary mortgage insurance. Although the Department has no current expectation that it will change its current policies regarding insurance and guarantees, it may change such expectations. Any change to the foregoing insurance and guaranty expectations could require an amendment to the Department's Program Operating Procedures and delivery of a new Cash Flow Statement. A significant principal amount of Contracts of Purchase, including Contracts of Purchase with LTVs above 80%, are not covered by loan insurance. See EXHIBIT 2 to this APPENDIX B - "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA - Contracts of Purchase - Existing Contracts of Purchase - Current Loan-to-Value Ratio of Contracts of Purchase."

Primary Mortgage Insurance. The Department purchased from Radian a policy of primary mortgage insurance for a pool of certain prior Contracts of Purchase with LTVs above 80%. This Radian policy provides coverage on such pool back to February 1, 1998. The Department has purchased an additional policy of primary mortgage insurance from Radian which provides the same coverage as provided in the original policy, except that the Department now includes certain existing and all new Contracts of Purchase with 97% to 100% LTV ratios that are not qualified for USDVA guarantees (except mobile homes in parks, construction loans and home improvement loans, all of which continue to be covered by the Department). Under this second policy, Radian has committed to insure both new and existing Contracts of Purchase presented by the Department for coverage until the earlier of December 31, 2004 or when the aggregate principal amount of Contracts of Purchase insured under the second policy reaches $1.6 billion. Each of the Radian policies provides for coverage for aggregate losses incurred on Contracts of Purchase following property disposition, above an aggregate 2% deductible based upon a percentage of the originally insured balances of the Contracts of Purchase of the applicable pool. Under both Radian policies, once the applicable aggregate deductible has been reached, insurance claims may be made based upon the individual LTV of the particular defaulted Contract of Purchase, as set forth below. For these purposes, LTV is calculated using the original appraised value of the property.

Radian Mortgage Insurance Coverage Ratios Subject to a Deductible of 2% of the Originally Insured Balances of the Contracts of Purchase in the Applicable Insured Pool

LTV Category	% of Coverage
97.01% to 100.00%	35%
95.01% to 97.00%	35%
90.01% to 95.00%	30%
85.01% to 90.00%	25%
80.01% to 85.00%	17%

For information regarding the principal amount of Contracts of Purchase covered by the Radian policies, see EXHIBIT 2 to this APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Existing Contracts of Purchase - Current Loan-to-Value Ratio of Contracts of Purchase."

USDVA Guaranty Program. The Department was approved by the USDVA as a "supervised lender with automatic processing authority" as of March 10, 1998. On July 27, 1998, the Department received USDVA approval under the Lender Appraisal Processing Program ("LAPP") to process appraisals and determine reasonable value without prior USDVA review. The Department seeks USDVA loan guarantees for all Contracts of Purchase with an LTV of 80% or higher, unless the Contract of Purchase is not eligible for USDVA guaranty. Contracts of Purchase not eligible for guaranty are primarily contracts with veterans who have previously used their USDVA guaranty eligibility and do not qualify for reinstatement, and contracts for the purchase of new homes not inspected by USDVA during construction. Also, a very small number of veterans have service that meets Veterans Code eligibility requirements but does not meet USDVA eligibility requirements.

The Servicemen's Readjustment Act of 1944, as amended, permits a veteran (or in certain instances the veteran's spouse) to obtain a mortgage loan guaranty from USDVA covering mortgage financing of the purchase or construction of a one-to-four family dwelling unit at interest rates permitted by USDVA. The USDVA program has no preset mortgage loan limits and permits the guaranty of mortgage loans of up to 30 years and 32 days' duration. Under the USDVA program, the maximum USDVA guaranty on a loan is the lesser of (a) the veteran's available entitlement (a maximum of $36,000, or if the original loan amount exceeds $144,000, a maximum of $50,750), or (b) (1) 50% of the original loan amount if such amount does not exceed $45,000, (2) $22,500 if the original loan amount is between $45,000 and $56,250, (3) the lesser of $36,000 or 40% of the original loan amount, if such amount is between $56,250 and $144,000, or (4) the lesser of $50,750 or 25% of the original loan amount, if such amount is in excess of $144,000. The liability on the guaranty is reduced or increased pro rata with any reduction or increase in the amount of indebtedness, but in no event will the amount payable on the guaranty exceed the amount of the original guaranty. Notwithstanding the dollar and per centum limitations of the guaranty, a mortgage holder will ordinarily suffer a monetary loss only where the difference between the unsatisfied indebtedness and the proceeds of a foreclosure sale of a mortgaged property is greater than the original guaranty as adjusted. Periods without interest payments prior to foreclosure will also increase the potential for losses. In the event of a default in the payment of a USDVA loan, but prior to a suit or foreclosure, USDVA may, at its option, pay to a mortgage holder the unpaid balance of the obligation plus accrued interest and receive an assignment of the loan and security. For information regarding the amount of Contracts of Purchase guaranteed by the USDVA, see EXHIBIT 2 to this APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Existing Contracts of Purchase - Current Loan-to-Value Ratio of Contracts of Purchase."

Property and Life and Disability Insurance

The Veterans Code and/or long-standing Department policy have called for a veteran to maintain certain insurance with respect to the property covered by a Contract of Purchase. Insurance must be in the amount and under the conditions specified by the Department, and is either provided by the Department or by insurance companies selected by the Department. Any change to the insurance requirements could require amending the Department's Program Operating Procedures.

Fire and Hazard Coverage. The Department self-insures for fire and hazard losses, using the 1943 Fund to make payments to veterans, up to a Department deductible. The Master Policy described below (the "Master Policy") provides $100,000,000 coverage in excess of the Department deductible, except that the Master Policy does not cover mobile homes, condominiums or planned unit development properties covered by blanket insurance policies provided by homeowners' associations. The Master Policy is provided by commercial insurers (the "provider"). The lead insurance company for the provider is Affiliated FM Insurance Company.

Under each Contract of Purchase, the veteran is required to pay the sum charged to his or her account to cover costs of providing the insurance coverage including the insurance premium due under the Master Policy with respect to his or her property. From the amount charged to each veteran, the Department retains a portion to provide the sums necessary to pay all losses up to the Department deductible, which is $1,500,000 per occurrence or $13,000,000 per policy year. If the total losses from a single occurrence exceed $1,500,000 or if the aggregate of all fire and hazard insurance losses for a policy year exceed $13,000,000, liability for the excess will be covered under the Master Policy. The coverage under the Master Policy extends to October 31, 2002. The Master Policy is an all-physical loss form.

Fire and hazard insurance coverage for participants in the Program is adjusted annually to reflect increasing building costs and is maintained on a guaranteed replacement cost basis for homes and on an actual cash value basis for outbuildings. A $250 deductible payable by the veteran applies to each loss. Claims must be submitted within 12 months of loss. Each veteran with a Contract of Purchase pays an annual insurance premium equal to $0.22 per $100 of insured value which is prorated and included in the veteran's monthly installment. Claims adjustments and payments are made on behalf of the Department and the provider of the Master Policy by an affiliate of such provider.

Disaster Indemnity Plan. The Department provides certain disaster indemnity and catastrophe real property insurance ("Disaster Indemnity Plan"). Neither such insurance nor the indemnity fund described below are payable from or a part of the 1943 Fund. The Disaster Indemnity Plan indemnifies participants against the cost of repairing damage in excess of a deductible caused by flood or earthquake. The deductible for flood losses is $500 and the deductible for earthquake losses is $500 or 5% of the amount of loss, whichever is higher. The catastrophe insurance has been obtained from a consortium of twelve insurance companies for a total of $50,000,000 of coverage with a $4,000,000 deductible per occurrence and in the aggregate annually; $100,000 per occurrence maintenance deductible thereafter. The 2001-2002 one-year premium for this coverage is $3,385,000.

Each veteran in the Program participates in the Disaster Indemnity Plan and pays his or her pro rata share of the annual premium. Such payments are deposited in an indemnity fund created in the Treasury of the State to be utilized to pay the deductible discussed above. Each veteran pays an initial assessment of $.95 per $1,000 of insured value, and any assessments as may be required to sustain the indemnity fund. The value of the indemnity fund as of June 30, 2001 was $18,480,576.

Effective December 1, 1997, the Department has purchased individual flood policies through the Federal Emergency Management Agency ("FEMA") covering all properties financed by Contracts of Purchase that are located in designated flood zones. Coverage under this policy is renewable annually.

Life and Disability Coverage. In the past, the Department self-insured from the 1943 Fund life and disability coverage for veterans with Contracts of Purchase. Following a period of significant and recurring losses incurred by the 1943 Fund, the Department, effective June 1, 1996, replaced most of the Department's self-insured life and disability insurance program with an interim life and disability insurance plan (the "Life and Disability Plan") provided by Pacific Life and Annuity Company ("Pacific Life") (previously PM Group Life Insurance Company). Effective February 1, 1998, after a competitive bidding process, the interim plan was replaced with a long-term life insurance and disability plan, also provided by Pacific Life. The Department continues to self-insure those veterans who were already receiving disability benefits at the time the Life and Disability Plan was implemented, with benefits equal to the amount of the monthly Contract of Purchase payment at the time of their disability. Those benefits will continue under the provisions of the self-insured plan until the beneficiary returns to active employment or dies, or his or her contract is paid off. Loss reserves for these obligations are actuarially based. A portion of the required loss reserves is maintained under a third-party administrator agreement and is shown in the financial statements for the 1943 Fund as deposits with insurance administrators. The remaining amount is unfunded, but reserved in the form of a loss against retained earnings. See "THE 1943 FUND – Selected Financial Data of the 1943 Fund and Department's Discussion" in this APPENDIX B.

As noted above, effective February 1, 1998, the Department implemented a new life and disability protection plan which is provided by Pacific Life. All holders of Contracts of Purchase who had life and disability coverage (exclusive of those receiving self-insured benefits as described in the preceding paragraph) under the prior plan were transferred automatically to the new plan. Major elements of the life and disability coverage will continue unchanged for all currently insured Contract of Purchase holders up to age 60. For formerly insured holders of Contracts of Purchase under age 60, 100% of the loan balance is covered. Life insurance coverages at subsidized rates for those currently insured Contract of Purchase holders in the program over age 60 are limited to a maximum of the loan amount or $75,000, if less, reducing in increments every 5 years to a maximum of $5,000 after age 80. If they so desire, such Contract of Purchase holders can obtain, at commercial insurers' rates, coverage for loan balances in excess of such amounts. Holders of new Contracts of Purchase after February 1, 1998 are covered under a revised insurance plan. The Department continues to require life insurance coverage but in an amount sufficient to cover home payments for five, three or one year(s) depending on the health of the individual loan applicant. All new Contract of Purchase applicants must apply for and must be provided the minimum life insurance coverage. Disability coverage for a period up to two years is optional for new Contract of Purchase holders after February 1, 1998, but is a mandatory requirement for Contract of Purchase holders with Contracts of Purchase in existence prior to February 1, 1998. The disability insurance benefit provides home loan protection by paying the participant's monthly loan installment (including insurance premiums) for a maximum benefit period of two years per disability, unless due to a psychiatric condition which would then limit the maximum benefit period to 12 months. Additional, full coverage, life insurance may also be purchased as an option by new Contract of Purchase holders. Spouse life insurance coverage is available as an option. The new plan is an experience rate plan subject to annual rating reviews of insurance claims, expenses, risk charges, profits and premiums. In addition to the new insurance coverages, the Department has established a one-time $5 million rate stabilization reserve intended to minimize the impact of premium increases for Contract of Purchase holders. The Department will retain the principal amount of such $5 million and any interest earnings on such amount as part of the 1943 Fund.

The Department's life and disability insurance program is the subject of a state audit report released in March 2001. See "External Reviews of the Program" in this APPENDIX B. The Department is in the process of soliciting bids from providers to determine the premium cost of increasing the disability benefits for Contract of Purchase holders.

THE 1943 FUND

General

The components of the 1943 Fund are (i) proceeds derived from the sale of Revenue Bonds, (ii) proceeds from the sale of Veterans G.O. Bonds, (iii) amounts receivable under all Contracts of Purchase and from sales of properties subject to cancelled Contracts of Purchase, (iv) temporary investments, cash and funds, and (v) certain other miscellaneous assets. Proceeds of Veterans G.O. Bonds may not be applied to payment of principal of, and interest or any redemption premium on, the Revenue Bonds. The holders of Revenue Bonds are not entitled to compel the sale of Contracts of Purchase and the properties to which they relate, but are entitled to receive payment out of the Revenues derived from those Contracts of Purchase and properties, subject to the prior claims, if any, of the Veterans G.O. Bonds and of the State for reimbursement of debt service payments made on Veterans G.O. Bonds.

In addition to financing Contracts of Purchase and paying or reimbursing of debt service on the Veterans G.O. Bonds and Revenue Bonds, as described below, moneys in the 1943 Fund are used to pay administrative costs of the Department, and to fund certain losses from and reserves for property insurance and life and disability insurance described above in this APPENDIX B under "THE PROGRAM – Property and Life and Disability Insurance."

For financial information concerning the 1943 Fund, see "Selected Financial Data of the 1943 Fund and Department's Discussion" and also see EXHIBIT 1 to this APPENDIX B – "FINANCIAL STATEMENTS OF THE 1943 FUND FOR FISCAL YEARS 2001 AND 2000 AND INDEPENDENT AUDITOR'S REPORT."

The Act and the Veterans Code provide that the undivided interest created by Resolution RB-1 in favor of the holders of Revenue Bonds in the assets of the 1943 Fund is secondary and subordinate to the interest of the people of the State and the holders of Veterans G.O. Bonds. Moneys in the 1943 Fund must be paid, on the debt service payment dates of Veterans G.O. Bonds, to the General Fund in the amount of the principal of (whether at maturity or upon redemption or acceleration), and premium and interest on Veterans G.O. Bonds then due and payable (other than debt service payable from the proceeds of refunding bonds). Debt service on Veterans G.O. Bonds is payable from the General Fund, even if the amount transferred from the 1943 Fund to the General Fund is less than such debt service amount. The balance remaining unpaid to the General Fund from the 1943 Fund must be transferred to the General Fund out of the 1943 Fund as soon thereafter as it becomes available, together with interest thereon at the rate borne by the applicable Veterans G.O. Bonds, compounded semiannually. Until such amounts are repaid to the General Fund, no payments may be made on the Revenue Bonds other than from amounts then in the Bond Reserve Account and the Loan Loss Account. These rights with respect to the 1943 Fund do not grant any lien on the 1943 Fund or the moneys therein to the holders of any Veterans G.O. Bonds.

As of August 1, 2001, there were outstanding $2,415,765,000 aggregate principal amount of Veterans G.O. Bonds, not including the Offered Veterans G.O. Bonds. Currently, $605,585,000 of new issue Veterans G.O. Bonds are authorized but not issued. The Offered

Veterans G.O. Bonds will not use any of such $605,585,000 authorization. As of August 1, 2001, there were outstanding $570,940,000 aggregate principal amount of Revenue Bonds, not including the Winter 2002 Revenue Bonds. Under the Act, Revenue Bonds in an aggregate principal amount not to exceed $1,500,000,000, at any given time, may be outstanding. The Legislature may increase the amount of Revenue Bonds issuable under the Act or may decrease such amount to an amount not less than the amount of Revenue Bonds then outstanding. Additional information about outstanding Veterans G.O. Bonds and Revenue Bonds is in EXHIBIT 2 to this APPENDIX B - "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA - Veterans G.O. Bonds and Revenue Bonds."

For additional information regarding the existing interest rates of, and setting interest rates on, Contracts of Purchase, see "THE PROGRAM - Contracts of Purchase" in this APPENDIX B and EXHIBIT 2 to this APPENDIX B - "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA - Contracts of Purchase."

Selected Financial Data of the 1943 Fund and Department's Discussion

Selected Financial Data of the 1943 Fund

The following selected financial data of the 1943 Fund for fiscal years ended June 30, 2001 and 2000 have been derived from the financial statements of the 1943 Fund audited by Deloitte & Touche LLP, independent auditors, whose report thereon appears in EXHIBIT 1 to APPENDIX B in this Official Statement, and the Department's accounting records. The following selected financial data of the 1943 Fund for fiscal years ended June 30, 1999, 1998 and 1997 have also been derived from the audited financial statements of the 1943 Fund which are not included herein. **This selected financial data should be read in conjunction with the financial statements and notes thereto of the 1943 Fund contained in said EXHIBIT 1 and the Department's Discussion of Financial Data contained herein.**

Beginning with the fiscal year ended June 30, 1998, the financial statements of the 1943 Fund are required to reflect accounting changes required by promulgation of Statement No. 31 by the Governmental Accounting Standards Board ("GASB 31"). GASB 31 requires all investments to be reported at their fair market value (rather than book value) and investment income to be adjusted to reflect the difference between the fair market and book value of investments as either a capital gain or loss. The financial data derived from the financial statements of the 1943 Fund for FY 1997 and presented in the tables below have been adjusted to reflect the impact of GASB 31 on investments and investment income so as to make such data consistent with the accounting procedures used in preparing the Department's financial statements for FY 1998 and thereafter.

The impact of GASB 31 adjustments over the five-year period reflected in the tables below (including FY 2001) are a cumulative increase of $2,225,000 in the deficiency of revenues over expenses and cumulative decrease of the same amount in retained earnings.

SELECTED FINANCIAL DATA OF THE 1943 FUND
(Dollars in Thousands)

	June 30, 2001	June 30, 2000	June 30, 1999	June 30, 1998	Restated June 30, 1997
ASSETS AND LIABILITIES RELATED TO LENDING AND FINANCING ACTIVITIES:					
CASH AND INVESTMENTS					
Cash and amounts on Deposit in SMIF*	$324,158	$226,076	$239,979	$325,321	$317,178
Guaranteed Investment Contracts	319,476	562,380	890,692	938,888	365,542
Treasury Securities	0	112,107	183,645	187,851	47,214
Total	643,634	900,563	1,314,316	1,452,060	1,029,934
DUE FROM VETERANS DEBENTURE REVENUE FUND	40,905	33,847	22,471	12,686	86,279
OTHER CURRENT ASSETS	30,333	30,903	18,335	13,755	22,596
NET OTHER NON-CURRENT ASSETS	33,329	33,255	33,262	36,406	15,123
CONTRACTS OF PURCHASE					
Performing Contracts	2,605,059	2,418,292	2,040,587	2,035,879	2,154,142
Non Performing Contracts	18,182	16,764	28,669	62,872	75,038
Total	2,623,241	2,435,056	2,069,256	2,098,751	2,229,180
Allowance For Contract Losses	(16,715)	(19,676)	(21,263)	(22,005)	(26,412)
Reduction of REO to Fair Value	(2,592)	(3,050)	(8,104)	(19,003)	(24,003)
Total	(19,307)	(22,726)	(29,367)	(41,008)	(50,415)
BONDS PAYABLE					
General Obligation Bonds	(2,415,765)	(2,528,330)	(2,687,390)	(2,947,165)	(2,632,045)
Revenue Bonds	(570,940)	(505,815)	(404,215)	(275,055)	(327,580)
Total	(2,986,705)	(3,034,145)	(3,091,605)	(3,222,220)	(2,959,625)
OTHER CURRENT LIABILITIES	(60,081)	(87,598)	(56,369)	(58,458)	(80,502)
Net Lending & Financing Activities Assets	**305,349**	**289,155**	**280,299**	**291,972**	**292,570**
ASSETS AND LIABILITIES RELATED TO INSURANCE ACTIVITIES:					
LIFE AND DISABILITY COVERAGE					
Deposits with Insurance Administrators	16,289	23,010	30,573	40,823	48,762
Insurance Reserves	(26,726)	(31,642)	(39,751)	(53,185)	(65,828)
Total	(10,437)	(8,632)	(9,178)	(12,362)	(17,066)
RATE STABILIZATION RESERVE FOR LIFE AND DISABILITY PREMIUMS**	(5,700)	(5,700)			
FIRE AND HAZARD COVERAGE					
Deposits with Insurance Administrators	1,850	1,850	1,850	1,850	1,850
Accrued Liabilities	(3,016)	(3,236)	(3,402)	(3,059)	(3,255)
Total	(1,166)	(1,386)	(1,552)	(1,209)	(1,405)
Net Insurance Activities Liabilities	**(17,303)**	**(15,718)**	**(10,730)**	**(13,571)**	**(18,471)**
RETAINED EARNINGS	**$288,046**	**$ 273,437**	**$ 269,569**	**$ 278,401**	**$ 274,099**
SUMMARY INFORMATION					
Total Assets	$3,344,000	$3,411,000	$3,435,000	$3,587,000	$3,377,000
Total Liabilities	3,056,000	$3,137,000	$3,166,000	$3,309,000	$3,103,000
Total Number of Contracts of Purchase	32,473	33,440	32,243	35,906	39,343

*Surplus Money Investment Fund
**Reclassification for Liabilities

SELECTED FINANCIAL DATA OF THE 1943 FUND
(Dollars in Thousands)

	June 30, 2001	June 30, 2000	June 30, 1999	June 30, 1998	Restated June 30, 1997
NET INCOME FROM LENDING AND FINANCING ACTIVITIES:					
INTEREST INCOME					
Interest on Contracts	$179,755	$150,213	$139,839	$162,086	$175,186
Interest on Investments	40,194	69,471	75,292	74,077	67,373
Transfers of Interest From Veterans Debenture Revenue Fund	2,219	1,476	887	3,317	10,843
Total	222,168	221,160	216,018	239,480	253,402
BOND INTEREST EXPENSE	(188,017)	(193,495)	(201,772)	(218,757)	(230,871)
Net Interest Income	**34,151**	**27,665**	**14,246**	**20,723**	**22,531**
RESERVE FOR RATE STABILIZATION		(5,700)			
GASB 31 ADJUSTMENT	351	479	(6,897)	(4,578)	8,420
GAIN ON SALE OF SECURITIES	1,130	270	2,351	13,460	
RESTRUCTURING EXPENSES	(3,642)	(2,629)	(6,342)	(3,068)	
	(2,161)	(7,580)	(10,888)	5,814	8,420
CONTRACTS OF PURCHASE					
PMI	(7,658)	(86)	(2,330)	(1,551)	
Net gain (loss) on Sale of REO'S	55	(2,683)	(3,886)	(3,128)	(8,309)
(Increase) Decrease in Allowance for Contract Losses	3,420	6,641	3,343	(1,312)	(22,677)
Total	(4,183)	3,872	(2,873)	(5,991)	(30,986)
Net Lending/Financing Activities Income (Expense)	**27,807**	**23,957**	**485**	**20,546**	**(35)**
NET INCOME FROM ADMINISTRATIVE ACTIVITIES					
Operating Revenues	8,128	5,779	3,826	1,891	2,290
Operating Expenses	(21,541)	(23,902)	(19,543)	(20,381)	(20,218)
Net Administrative Activities Expense	**(13,413)**	**(18,123)**	**(15,717)**	**(18,490)**	**(17,928)**
NET INCOME FROM INSURANCE ACTIVITIES					
Life and Disability Coverage	(2,571)	(3,374)	5,290	160	3,570
Fire and Hazard Coverage	2,786	1,408	1,110	2,086	326
Net Insurance Activities Income (Expense)	**215**	**(1,966)**	**6,400**	**2,246**	**3,896**
TOTAL EXCESS (DEFICIENCY) OF REVENUES AND TRANSFERS OVER EXPENSES	**14,609**	**3,868**	**(8,832)**	**4,302**	**(14,067)**
RETAINED EARNINGS	$288,046	$ 273,437	$ 269,569	$ 278,401	$ 274,099

Department's Discussion of Financial Data

Certain aspects of the Department's financial results as presented in the five-year tables are discussed below. While the financial results for FY 2001 are the most positive during the five-year period, the continued implementation of the Department's programmatic and financial management revisions may result in losses in future years.

Overview. Although the Program has experienced losses during two of the last five years, the impact of significant programmatic and financial management changes implemented substantially during FY 1998 is evidenced in the FY 2001 financial results. Since FY 1996, the Department has (a) expanded eligibility requirements for borrowers and created competitive Program terms to stimulate growth of its portfolio of Contracts of Purchase, (b) established a flexible interest rate setting mechanism on new Contracts of Purchase, (c) secured primary mortgage insurance for over $700,000,000 of outstanding Contracts of Purchase previously self-insured by the 1943 Fund, (d) implemented requirements for guarantees by the United States Department of Veterans Affairs or other primary mortgage insurance on most newly originated high loan-to-value ("LTV") Contracts of Purchase, (e) converted a majority of its life and disability coverage plan from a self-insured program to third-party insurance, (f) revised Contract of Purchase underwriting and servicing procedures to improve the performance of the Contracts of Purchase portfolio, including aggressive disposition of its inventory of repossessed properties ("REOs") to reduce carrying costs and exposure on previously defaulted Contracts of Purchase, and (g) implemented a new Integrated Loan Processing and Financial Information Management System for origination and servicing of new Contracts of Purchase.

The 1943 Fund, which is the sole operating fund for the Program, reflects a retained earnings balance of $288,046,000 as of June 30, 2001 which represents an increase of 5.3% over the prior year. The overall asset-to-liability ratio for the 1943 Fund increased to 109% up from an average of 108% over the prior four fiscal years. The excess of revenues over expenses for the Program for FY 2001 was $14,609,000 and represents a $10,741,000 increase over the FY 2000 gain of $3,868,000, largely as a result of: (a) continued improvement in net interest income and (b) the one-time charge for the life and disability coverage rate stabilization reserve which was reflected in the prior year.

Assets and Liabilities. From FY 2000 to FY 2001, the outstanding balance of Contracts of Purchase (as measured at fiscal year end) increased by 7.7% from $2,435,056,000 to $2,623,241,000. The amount of Contracts of Purchase funded during FY 2001 was $469,119,000, consisting of funding from the following sources of approximately: (a) $139,500,000 of bond proceeds, (b) $151,000,000 of recycled Contracts of Purchase principal receipts (including prepayments) and (c) $178,619,000 of other invested funds. New originations during FY 2001 were offset by prepayments of Contracts of Purchase of $189,902,000 and scheduled repayments of principal of $91,033,000.

The ability of the Department to sustain the increase in the outstanding balance of Contracts of Purchase in future periods will depend upon a variety of factors including, among others: (a) the level of mortgage interest rates offered in the private market relative to the interest rates established from time-to-time by the Department for newly originated Contracts of Purchase, the general level of home purchase and construction activity in the State, and the demographics of the eligible veterans population, which will each directly impact the rate of origination of Contracts of Purchase, (b) the level of mortgage interest rates offered in the private market relative to the interest rates on outstanding Contracts of Purchase, which will directly impact the rate of prepayment of Contracts of Purchase, and (c) the seasoning of the outstanding Contracts of Purchase, which will directly impact the rate of scheduled principal receipts. The Department has experienced significant variation in the change in the outstanding balance of Contracts of Purchase in prior fiscal years. See also EXHIBIT 2 to APPENDIX B - "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA - Contracts of Purchase - Selected Principal Flows with respect to Contracts of Purchase Funded by both Veterans G.O. Bonds and Revenue Bonds."

The Department's Contracts of Purchase interest-rate setting mechanism permits it to periodically adjust the interest rates on newly originated Contracts of Purchase. As a result of such mechanism, interest rates for new Contracts of Purchase funded on and after September 1, 2001 are currently 6.00% for Contracts of Purchase financed using Qualified Mortgage Bond Proceeds, 6.25% for Contracts of Purchase financed using Qualified Veterans Mortgage Bond Proceeds, and 6.50% for Contracts of Purchase using Unrestricted Moneys.

During FY 2001, cash and investments declined by $256,929,000. Most of this reduction is due to the application of such funds to finance new Contracts of Purchase. The balance of this reduction is the result of such funds being applied to debt retirement.

Beginning in FY 1996, the Department moved aggressively to repossess properties of canceled Contracts of Purchase and dispose of its REOs which had increased significantly in the early 1990's due to the decline in real estate values and overall economic conditions in certain California housing sub-markets. The principal balance of Contracts of Purchase classified as REOs increased by $1,418,000 from June 30, 2000 to June 30, 2001. However, the aggregate reduction in Contracts of Purchase classified as REOs from June 30, 1997 to June 30, 2001 is $56,856,000. Due to the increased size of the portfolio, as well as continued aggressive REO management and disposition efforts, the amount of non-performing Contracts of Purchase at June 30, 2001 remained at approximately 0.7% of the Department's portfolio.

In conjunction with this effort, the Department periodically reassesses the adequacy of its loss reserves. During FY 2001, the Department's loss allowance was reduced by $3,420,000 due to the adequacy of reserves funded in prior years, improvement in the overall performance of the Contract portfolio and insurance coverage. Accumulated loss reserves decreased $31,108,000 or 61.7% over the last four years. The remaining loss reserve of $19,307,000 at June 30, 2001, together with the Department's (a) purchase of primary mortgage insurance during FY 1998 with respect to certain outstanding Contracts of Purchase with high LTVs, (b) imposition of USDVA guarantees for certain high LTV Contracts of Purchase originated beginning in April 1998, and (c) imposition of additional primary mortgage insurance provided by Radian for certain newly originated high LTV Contracts of Purchase which are not eligible for USDVA guarantees are intended to provide for future potential REO losses. (see "THE PROGRAM - Loan Insurance" in this APPENDIX B.)

In FY 2001 the Department continued to reduce its exposure to market volatility with the final liquidation of the portfolio of Treasury securities previously held directly in the 1943 Fund and the increased use of investment contracts for various accounts. See EXHIBIT 2 to this APPENDIX B – "CERTAIN DEPARTMENTAL FINANCIAL INFORMATION AND OPERATING DATA."

The Department continued the addition of long-term Revenue Bonds into its overall debt structure with such bonds making up 19.1% of all outstanding Veterans G.O. Bonds and Revenue Bonds at June 30, 2001 – the highest level since 1995. The growth rate of additional Revenue Bonds should decrease as a result of the substantial completion of the Department's pre-Ullman (defined herein) refunding efforts, which provide Unrestricted Moneys to finance Contracts of Purchase for certain veterans. In addition, during FY 2001, the Department continued to reduce the impact of non-callable Veterans G.O. Bonds issued in the early 1980's. By June 30, 2001, approximately $658,790,000 of such bonds remained outstanding, with a remaining average life of only 4.6 years and an average interest cost of approximately 9%. As of June 30, 2001, the non-callable bonds represent 22% of the total Veterans G.O. Bonds and Revenue Bonds outstanding.

Beginning June 1, 1996, the Department's self-insured life and disability coverage plan was transferred to a fully-insured interim plan underwritten by an outside commercial insurer except for that portion of the life and disability insurance program covering existing claims of disabled Contract of Purchase holders for whom the Department continues to provide coverage. Effective February 1, 1998, the interim plan was replaced, after a competitive bidding process, by a replacement, long-term life insurance and disability plan provided by the same commercial insurer. During FY 2000, the Department established a reserve in the amount of $5,700,000 to provide a source for stabilizing premiums to Veterans under the life and disability insurance program. To date, no portion of such reserve has been utilized.

For those Contract of Purchase holders for whom the Department continues to provide self-insured coverage, loss reserves for such obligations have been actuarially based and have been decreased in FY 2001 based on the characteristics of the Department's Contracts of Purchase portfolio and the amount of funded reserves. Approximately 61% of such loss reserves are funded and maintained under a third party administrator agreement. The remaining amount is unfunded, but reserved in the form of an accrued liability.

Income and Expenses. The Program's FY 2001 net interest income (total interest income less bond interest expense) of $34,151,000 was $6,486,000 greater than FY 2000. However, the FY 2000 net interest income amount includes a non-recurring item of approximately $7,300,000 for recognition of investment earnings which were received on refunding escrows established in prior years. Comparing FY 2001 net interest income to an adjusted FY 2000 net interest income amount of $20,365,000 to exclude this non-recurring item, results in an increase in both net interest income of $13,786,000 and net interest margin (net interest income divided by average interest bearing assets) of 1.02%. This increase in net interest margin from 0.60% in FY 2000 reflects (a) the continued conversion of lower yielding investments to higher yielding Contracts of Purchase, (b) the reduced interest expense as high coupon non-callable bonds matured, and (c) the reduced interest expenses as high coupon callable bonds were refunded. As a result of the shift of assets from investments to Contracts of Purchase, FY 2001 interest income from Contracts of Purchase increased by $29,542,000 while interest income from investments fell by only

$21,977,000 (as adjusted for the recognition of escrow earnings as described above), even though the average interest bearing assets fell by 1.5%. As a result of maturing non-callable debt, interest expense on such bonds in excess of interest income on related Contracts of Purchase fell by approximately $1,400,000 when compared to the prior year. Interest expense on the remainder of the outstanding bonds was favorably affected by the refunding of $295,330,000 of callable bonds during FY 2000 and FY 2001.

The ability of the Department to sustain the increase in net interest income in future periods will depend upon a variety of factors including, among others: (a) the level of interest rates available on short term investments (including the rate paid on SMIF and on newly acquired investment contracts) relative to the level of interest rates on outstanding bonds, (b) the rate of origination and the rate of prepayment of Contracts of Purchase, which will directly impact the amount of bond proceeds, recycling funds, and revenues held in such investments, (c) the interest rates established from time to time by the Department for newly originated Contracts of Purchase relative to the interest cost on bonds issued to finance such Contracts of Purchase, and (d) the interest rates on outstanding Contracts of Purchase relative to the interest cost on outstanding bonds, which will directly depend on the Department's ability to use special and optional redemption provisions to minimize the overall cost of outstanding debt. The Department has experienced significant variation in net interest income over the prior fiscal years.

In addition, income was positively affected in FY 2001 by a $1,130,000 increase in the effect of realized and unrealized gains on securities due to changes in market value and a $351,000 increase to reflect GASB 31 accounting requirements. During FY 2001 income was negatively affected by continued amortization of $3,642,000 of the financing and redemption costs relating to the issuance of and refunding of bonds, which are expected to represent recurring expenses for future years' operations.

In FY 2001, the Department realized a small gain in its real estate risk activities, and a small gain in its insurance activities from the existing life and disability coverage plan and fire and hazard coverage plan.

Program administrative operating expenses in FY 2001 were $21,541,000, a decrease of 9.9% from FY 2000. This reduction is due in part to completion of the implementation of the Department's Integrated Loan Processing and Information Management System. A substantial portion of the increase in operating revenues for FY 2001 is attributable to loan guaranty fees which are also taken into account in the number reflected under "Contracts of Purchase - PMI."

The Financial Statements of the 1943 Fund for Fiscal Years 2001 and 2000 and the Independent Auditors' Report can be found in EXHIBIT 1 to this APPENDIX B. "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA" can be found in EXHIBIT 2 to this APPENDIX B.

External Reviews of the Program

The Program has been the subject of several external reviews by the executive and legislative branches of State government. A summary of certain of these reviews is presented below.

The Legislative Analyst's Office of the State of California

The Legislative Analyst's Office of the State of California (the "LAO") issued a 1998 report entitled "Rethinking the Cal-Vet Loan Program (the "1998 Report") and an analysis of the then-proposed Governor's Budget 1999/2000, which analysis included a discussion of the Department (the "1999 Report" and, together with the 1998 Report, the "1998/99 LAO Reports.") The stated purpose of the LAO is to provide analysis and nonpartisan advice to the California Legislature on fiscal and policy issues. The LAO is overseen by the Joint Legislative Budget Committee, a 14-member bipartisan committee composed of an equal number of State Assembly and State Senate members.

In the 1998/99 LAO Reports, the LAO analyzed the historical and recent financial performance and lending activities of the Department and made various recommendations. The 1998/99 LAO Reports described the financial losses experienced by the Department, the increasing rate of repayment of Contracts of Purchase, and the decreased lending activity in recent years. The 1998/99 LAO Reports were issued before the impact of the Department's recent programmatic changes had been realized.

In his proposed budget for Fiscal Year 1999-2000, Governor Davis listed several steps intended to improve the operation of State programs for veterans. Those most relevant to the Program are (a) appointment of an inspector general or internal auditor for the Department (which has occurred), (b) a request to the Bureau of State Audits (the "BSA") to conduct a fiscal and program compliance audit of the Program (which also has occurred and is discussed below), and (c) direction to the Secretary of Veterans Affairs to report to the Governor on the need for further restructuring of the Program and on ways that the "surplus funds in the home program" might be redirected to other pressing needs of veterans. As directed, the Department submitted a report to the Governor which, among other things, advised the Governor that, in its view, there are no "surplus" funds in the home program as the term implies. No new gubernatorial directives have been issued to the Department.

On February 17, 2000, the LAO issued an analysis of the proposed Governor's Budget for Fiscal Year 2000-01, which analysis included a discussion of the Department. The report recognized that the administrative costs of the Program are not part of the State budget, but recommended that the Department report to the State Legislature during budget hearings on the reasons for certain cost increases and the steps it is taking to reduce such costs. The LAO did not address the Program, Veterans G.O. Bonds, Revenue Bonds, or the 1943 Fund in its reports on the Governor's Budget for Fiscal Year 2001-2002.

Bureau of State Audits

On January 5, 2000, the Legislature directed the BSA to conduct an audit of the California Veterans Farm and Home Loan Purchase Program (loan program). The legislative request called for assessment of, among other things, whether the Department achieves its mission with its loan programs, the financial condition of the loan program and the reasonableness and appropriateness of expenditures, the relationship of the Department's lending standards to those in the lending industry and whether those standards are adhered to in the Department's lending process, and the demographics of eligible war veterans and the impact thereof on the loan program's viability.

On May 25, 2000, the BSA released an audit report concluding that the loan program will substantially lose its ability to offer low-cost home loans to veterans beyond the next decade due to the restrictive eligibility requirements attributed to certain program funding and the limited availability of other funding sources. The BSA further concluded that the Department was eroding loan program funds due to insufficient budget controls, inefficient and inconsistent loan operations and by charges to the loan program for unrelated administrative positions and costs. Finally, the BSA concluded, based in part upon its conclusion that the Department's testing of its integrated information system was incomplete, that the Department will need to spend more time and money to ensure that its integrated information system provides necessary, reliable program and financial information.

In a written response to the May 25, 2000 report, the Department disagreed with certain conclusions of the BSA and expressed the belief that it has already addressed certain report findings. In particular, the Department projects that the loan program will be attractive to a much higher percentage of eligible veterans than estimated by the BSA. Further, the Department believes that additional loan sources can be created through additional allocations of Qualified Mortgage Bonds loans and the blending of Unrestricted Moneys tax-exempt bonds with taxable bonds. In addition, the Department contends that steps have already been taken to ensure that information systems are properly administered and that loan program data and assets are adequately safeguarded. As part of the Department's plan to implement corrective action in certain areas identified by the BSA, the Department, upon the recommendations of an outside consultant, has undertaken steps designed to ensure proper allocation of its direct and indirect administrative costs to the loan program.

On March 28, 2001, the BSA released an audit report prepared in response to the Legislature's direction for an audit of the Department's life and disability insurance program. In its report, the BSA concluded that changes made to the Department's life and disability insurance program in 1996 reduced the Department's financial liabilities but also reduced the insurance program's benefits for veterans. The analysis in the audit report divides the Department's insurance program into two principal parts: the self-funded plan and the commercial plan. The self-funded plan is closed to new participants and covers veterans who were disabled when the Department converted in 1996 to the commercial plan. The commercial plan includes veterans in the Department's self-funded mandatory plan which preceded the commercial insurance and veterans who obtained their Contracts of Purchase after implementation of the commercial insurance. The BSA concluded that the self-funded portion of the insurance program is currently underfunded. In addition, the BSA concluded that the short-term nature of commercial insurance policies, the high cost of a self-funded insurance program, the scarcity of available funding sources, and the unpredictability of future participation in the loan and insurance programs impose difficulties in forecasting the long-term costs of the insurance program. The BSA also concluded that the Department's administration of the insurance program contains flaws that weaken the Department's ability to manage the insurance program and safeguard assets.

The BSA urged the Department to develop a long-term strategy to address its insurance program. The BSA suggested that the Department, in deciding the future of the insurance program, consider the above-listed factors in forecasting costs of the program. The BSA further suggested that the Department could increase funding for the insurance program using a limited amount of loan program funds that would not adversely affect the Department's ability to meet bond payments, through modest increases in premiums, and through savings in the operational costs for the loan program. In addition, the BSA suggested that the Department consider discontinuing the insurance program for certain veterans who are not currently disabled. Finally, the BSA suggested that the Department follow State guidelines to improve the administration of the insurance program.

In a written response to a draft of the audit report, the Department stated that sufficient funds to pay liabilities under the self-funded plan are made available as needed and that the current cash reserves are more than adequate for such purposes for the immediate future. The Department agreed with the BSA's suggestion of factors it should consider when deciding the future of the insurance program, but noted that its primary responsibility is to ensure the health of the Program overall. Finally, the Department asserted that it has already taken steps to conform its administration of the insurance program to State guidelines. See "THE PROGRAM – Property and Life and Disability Insurance" and EXHIBIT 2 to this APPENDIX B –"CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA" herein.

Copies of the 1998/99 LAO Reports and the May 25, 2000 and March 28, 2001 reports of the BSA, including the Department's responses thereto, are available from the Department upon request.

The financial performance of and loan origination activities of the Department are discussed elsewhere in this Official Statement. The Department does not believe that either termination of loan originations or use of Department moneys to fund other programs, if either or both of such actions were implemented, would have an adverse impact on the Department's ability to pay scheduled principal of and interest on any Veterans G.O. Bonds or Revenue Bonds. While the Legislature could enact any or all of the recommendations in the 1998/99 LAO Reports or any recommendations of the BSA, use of moneys in the 1943 Fund for veterans benefits outside of the Program may be subject to approval by the electorate of the State and may also be subject to other legal restrictions. See "AUTHORIZATION OF AND SECURITY FOR THE OFFERED VETERANS G.O. BONDS – Security For and Payment of Veterans G.O. Bonds," APPENDIX B – "THE 1943 FUND – Selected Financial Data of the 1943 Fund and Department's Discussion," EXHIBIT 1 to this APPENDIX B – FINANCIAL STATEMENTS OF THE 1943 FUND FOR FISCAL YEARS 2000 AND 1999 AND INDEPENDENT AUDITOR'S REPORT" and EXHIBIT 2 to this APPENDIX B "– CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA" herein.

Debbs Litigation

On June 25, 1996, the Department was served with a summons and complaint initiating a lawsuit entitled *John L. Debbs, et al. v. California Department of Veterans Affairs, et al.* (Superior Court of California, County of Los Angeles, Case No. BC 151476). The third amended complaint alleges "fraudulent concealment, declaratory relief, injunctive relief, and damages for monies unlawfully taken from the California Veterans Farm and Home Life and Disability Protection Plan." Plaintiff claims that in 1983, when the Department canceled its contracts with two life insurance companies then responsible for underwriting the life and disability programs, an amount exceeding $100 million in insurance reserves, which was returned to the Department, thereafter was illegally expended by the Department, and that certain transfers from the life and disability reserves to the 1943 Fund were unlawful. The complaint seeks, among other things, a determination that premiums under the life and disability program be reduced to prior levels and the return of the moneys, plus interest, from the 1943 Fund to the life and disability reserves. Plaintiffs failed in their attempts to obtain a preliminary injunction and temporary restraining order, seeking to stop the Department from foreclosing Contracts of Purchase of veterans who have disability claims under the Department's current disability insurance program. Plaintiffs are appealing the denial of the preliminary injunction. The case was certified as a class action, but in December 2000, the court decertified the class for failure to notify the class members. That decertification decision has also been appealed. The appeals of the denial of the preliminary injunction and the decertification of the class are proceeding, though no date has been set for oral argument. The case as to the original named plaintiffs is stayed pending resolution of these appeals, though informal discovery has been permitted, and a status conference has been scheduled for March 20, 2002.

The Department is vigorously opposing the lawsuit. While the outcome of any litigation cannot be predicted with certainty, the Department expects ultimately to prevail in this matter. Even if the Plaintiffs should prevail in this matter, the Department does not expect such an outcome to affect timely payment of debt service on the Offered Veterans G.O. Bonds.

Excess Revenues

The Department has covenanted with the holders of its Revenue Bonds to apply Revenues received with respect to Contracts of Purchase, after payment or reimbursement of debt service on Veterans G.O. Bonds, in a specified order of priority. The availability and use of Revenues can provide moneys for special redemption of the Offered Veterans G.O. Bonds (see "THE OFFERED VETERANS G.O. BONDS – Redemption – Special Redemption from Excess Revenues). For this purpose, "Revenues" means all moneys received by or on behalf of the Department representing (i) principal and interest payments on the Contracts of Purchase including all prepayments representing the same and all prepayment premiums or penalties received by or on behalf of the Department in respect to the Contracts of Purchase, (ii) interest earnings received on the investment of amounts to the extent deposited in the revenue account established under the Revenue Bond Resolution, (iii) amounts transferred to the revenue account from the bond reserve account or the loan loss amount established under the Revenue Bond Resolution, and (iv) any other amounts payable by parties executing Contracts of Purchase or private participants in the Program or related to recoveries on defaulted Contracts of Purchase, including origination and commitment fees, servicing acquisition fees, liquidation proceeds, and insurance proceeds, *except* to the extent not included as "Revenues" pursuant to the provisions of any resolution authorizing the issuance of a series of Revenue Bonds.

The Department has covenanted with the Revenue Bond holders to administer the 1943 Fund and the Program and perform its obligations to such holders in accordance in all material respects with the then-current Program Operating Procedures. The Program Operating Procedures are operating policies of the Department governing the discretionary activities of the Department under the Revenue Bond Resolution. The Department may amend the Program

Operating Procedures. The Program Operating Procedures will affect the Excess Revenues that will become available to redeem the Offered Veterans G.O. Bonds.

The Department has covenanted with the Revenue Bond holders to apply Revenues in the following order, after paying, or reimbursing for payments of, debt service on Veterans G.O. Bonds, including the costs of liquidity and credit enhancement facilities related thereto, and setting aside moneys as required under the Federal Tax Code to preserve the tax-exempt status of certain Veterans G.O. Bonds and Revenue Bonds, (1) to pay debt service on Revenue Bonds, (2) to pay the costs associated with liquidity and credit enhancement facilities, if any, for Revenue Bonds, (3) to replenish certain reserve funds established for the Revenue Bonds, (4) if the Department elects, to pay Department expenses, (5) to set aside a monthly accrual of Veterans G.O. Bond debt service, (6) if the Department elects, to finance Contracts of Purchase, and (7) with respect to Excess Revenues and certain tax restricted moneys, to redeem Veterans G.O. Bonds, including the Offered Veterans G.O. Bonds, and Revenue Bonds. For such purposes:

(a) "Excess Revenues" means, as of any date of calculation, Revenues in excess of Accrued Debt Service;

(b) "Accrued Debt Service" means, as of any date of determination and, as the context requires, with respect to all Revenue Bonds and Veterans G.O. Bonds (including the Offered Veterans G.O. Bonds), the sum of:

(i) the aggregate amount of scheduled interest and principal (except to the extent otherwise to be redeemed pursuant to clause (ii) or (iii) below) to become due after such date but on or before the end of the current debt service year, *less* the product of (x) the number of whole months remaining in the current debt service year and (y) the Monthly Debt Service Requirement;

(ii) the redemption price of bonds for which notice of redemption has been issued, provided such redemption price is to be paid from amounts on deposit in the revenue account created under the Revenue Bond Resolution; and

(iii) the redemption price of bonds that the Department will be obligated to redeem prior to the end of the next succeeding debt service year, to the extent that such obligation arises on account of amounts on deposit in such revenue accounts; and

(c) "Monthly Debt Service Requirements" means, as of any date of determination, one-twelfth of the aggregate amount of scheduled interest and principal to become due during the debt service year in which such date falls, as computed on the first day of such debt service year.

Maintenance of Fund Parity

The Revenue Bond Resolution requires the Department to calculate "Fund Parity" at least annually. "Fund Parity" means (a) an amount equal to the difference between (i) all assets in the 1943 Fund and in the accounts established under the Revenue Bond Resolution, and (ii) the principal amount of all Revenue Bonds and Veterans G.O. Bonds outstanding (plus accrued interest) reduced by (b) defined allowances and reserves for loss coverage on Contracts of Purchase and life and disability coverage on persons obligated under Contracts of Purchase. If any such calculation shall not reflect that Fund Parity at least equals the percentage required by the Revenue Bond Resolution, the Department may be required to expend Excess Revenues to redeem Revenue Bonds until its recalculations of Fund Parity meet the test required by the Revenue Bond Resolution.

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EXHIBIT 1

FINANCIAL STATEMENTS OF THE 1943 FUND
FOR FISCAL YEARS 2001 AND 2000
AND INDEPENDENT AUDITORS' REPORT

VETERANS FARM AND HOME BUILDING FUND OF 1943,
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

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VETERANS FARM AND HOME BUILDING FUND OF 1943, DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

Financial Statements for the Years Ended June 30, 2001 and 2000 and Independent Auditors' Report

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INDEPENDENT AUDITORS' REPORT

To the California Veterans Board
State of California
Sacramento, California

We have audited the accompanying balance sheets of the Veterans Farm and Home Building Fund of 1943 ("the Fund"), which is adm inistered by the Department of Veterans Affairs of the State of California ("the Department") as of J une 30, 2001 and 2000, and the related statements of revenues, expenses and changes in retained earnings, and of cash flows for the years then ended. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Veterans Farm and Home Building Fund of 1943, and are not intended to present the financial position of the Department of Veterans Affairs of the State of California and the results of its operations and cash flows of its proprietary fund types.

In our opinion, such financial statements referred to above present fairly, in all material respects, the financial position of the Veterans Farm and Home Building Fund of 1943, of the Department of Veterans Affairs of the State of California as of June 30, 2001 and 2000, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte + Touche LLP

October 27, 2001

VETERANS FARM AND HOME BUILDING FUND OF 1943, DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

BALANCE SHEETS
JUNE 30, 2001 AND 2000 (in thousands)

	2001	2000
ASSETS		
CASH IN STATE TREASURY	$ 20,393	
INVESTMENTS:		
Unrestricted	327,442	$ 279,662
Restricted	295,799	620,901
Insurance administrators	18,139	24,860
Total investments	641,380	925,423
RECEIVABLES UNDER CONTRACTS OF SALE, Net of allowance for uncollectible contracts of $16,715 in 2001 and $19,676 in 2000	2,588,344	2,398,616
DUE FROM VETERANS DEBENTURE REVENUE FUND	40,905	33,847
INTEREST RECEIVABLE:		
Contracts of sale	18,615	15,455
State of California's Surplus Money Investment Fund	3,301	3,528
Other investments	1,607	4,968
DUE FROM OTHER FUNDS	6,810	6,952
OTHER REAL ESTATE OWNED, Net of allowance for losses of $2,592 in 2001 and $3,050 in 2000	15,590	13,714
LAND, IMPROVEMENTS AND EQUIPMENT, Net of accumulated depreciation of $9,260 in 2001 and $8,080 in 2000	6,273	7,288
OTHER	819	933
TOTAL ASSETS	$3,344,037	$3,410,724
LIABILITIES AND RETAINED EARNINGS		
LIABILITIES:		
Cash overdraft due to State Treasury		$ 17,340
Accrued interest and other liabilities	$ 61,687	71,785
Due to other funds	170	
Bonds payable - net	2,960,468	3,009,111
Insurance claims payable and loss reserves	33,666	39,051
Total liabilities	3,055,991	3,137,287
RETAINED EARNINGS	288,046	273,437
TOTAL LIABILITIES AND RETAINED EARNINGS	$3,344,037	$3,410,724

See notes to financial statements.

VETERANS FARM AND HOME BUILDING FUND OF 1943, DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS YEARS ENDED JUNE 30, 2001 AND 2000 (in thousands)

	2001	2000
PROGRAM OPERATIONS:		
Interest revenues:		
Contracts of sale of properties	$ 179,755	$ 150,213
Investments and other	42,748	71,607
Transfers of revenue from Veterans Debenture Revenue Fund	2,219	1,476
Total program operations revenues	224,722	223,296
Expenses:		
Interest expense	188,017	193,495
Reversal of allowance for uncollectible contracts	(3,420)	(6,641)
Total program operations expenses	184,597	186,854
Excess of program operations revenues over program operations expenses	40,125	36,442
PROGRAM ADMINISTRATION:		
Revenues:		
Loan fees	7,190	4,784
Other income	938	995
Excess of amounts charged to contract holders over fire and hazard insurance claims and expenses and changes in insurance reserves	2,786	1,408
Total program administration revenues	10,914	7,187
Expenses:		
Payroll and related costs	12,682	12,241
General and administrative expenses	20,159	20,076
Excess of self-insured life and disability insurance claims and expenses and changes in insurance reserves over amounts charged to contract holders	3,644	4,761
Total program administration expenses	36,485	37,078
Excess of program administration expenses over program administration revenues	(25,571)	(29,891)
GAIN (LOSS) ON SALE OF REPOSSESSED PROPERTY	55	(2,683)
EXCESS OF REVENUES OVER EXPENSES	14,609	3,868
RETAINED EARNINGS:		
Beginning of year	273,437	269,569
End of year	$ 288,046	$ 273,437

See notes to financial statements.

VETERANS FARM AND HOME BUILDING FUND OF 1943, DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2001 AND 2000 (in thousands)

	2001	2000
CASH FLOWS FROM OPERATING ACTIVITIES:		
Excess of revenues over expenses	$ 14,609	$ 3,868
Adjustments to reconcile to net cash used by operating activities:		
Amortization of bond premiums, discounts and issuance costs	4,674	1,855
Reversal of allowance for uncollectible contracts	(3,420)	(6,641)
Depreciation	1,180	1,094
Loss on sale of repossessed property	(55)	2,683
Effect of changes in assets and liabilities:		
Interest receivable - State of California's Surplus Money Investment Fund	227	470
Interest receivable - other investments	3,361	3,246
Interest receivable - contracts of sale	(3,160)	(4,944)
Due from other funds	142	(829)
Other real estate owned	(1,821)	4,168
Other assets	114	(467)
Accrued interest and other liabilities	(10,098)	21,809
Due to other funds	170	
Insurance claims payable and loss reserves	(5,385)	(4,102)
Net cash provided by operating activities	538	22,210
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net increase in receivables under contracts of sale	(186,308)	(383,162)
Net decrease in investment securities	284,043	421,316
Purchase of land, improvements and equipment	(165)	(804)
Net cash provided by investing activities	97,570	37,350
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Increase (decrease) in cash overdraft due to State Treasury	(17,340)	10,947
Proceeds from sales of bonds	538,026	243,700
Maturities of bonds payable	(90,975)	(162,991)
Early redemption of bonds payable	(494,660)	(139,840)
Net decrease in Due from Veterans Debenture Revenue Fund	(7,058)	(11,376)
Additions to deferred financing costs	(5,708)	
Net cash used by noncapital financing activities	(77,715)	(59,560)
INCREASE IN CASH IN STATE TREASURY	20,393	-
CASH IN STATE TREASURY:		
Beginning of year	-	-
End of year	$ 20,393	$ -

See notes to financial statements.

VETERANS FARM AND HOME BUILDING FUND OF 1943, DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2001 AND 2000

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Description - The California Department of Veterans Affairs (the Department) is a separate legal entity and a Cabinet level agency of the State of California. A seven-member California Veterans Board (the Board) has policy oversight of the operations of the Department. The Board's membership consists of the Department Secretary and six members, all of whom are appointed by the Governor, subject to confirmation by the State Senate. The Veterans Farm and Home Building Fund of 1943 (the Fund) was established under the authority of the California Constitution to provide low-interest, long-term farm and home mortgage loan contracts to veterans living in California. The contract loan program has been continuous since 1922. Proceeds from the sale of general obligation bonds, periodically authorized by the vote of the people of California, and revenue bonds authorized by the Legislature are used for contract loans to veterans. Expenditures are primarily for debt service and administration of the program. The Fund is tax exempt.

The financial statements represent only the activities of the Veterans Farm and Home Building Fund of 1943, and are not intended to present the financial position of the Department of Veterans Affairs of the State of California and the results of its operations and cash flows of its proprietary fund types. The financial statements of the Fund are included in the financial statements of the State of California as the State represents the primary government and has ultimate oversight responsibility for the Fund.

Use of Estimates in the Preparation of Financial Statements - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Basis of Accounting - The Fund has been classified as a governmental proprietary fund type for accounting purposes. Generally, revenues are recorded when earned and expenses are recognized as incurred.

Governmental Accounting Standards Board Statement No. 20 (GASB No. 20), *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Funds Accounting*, established standards for accounting and financial reporting for proprietary funds. In accordance with GASB No. 20, the Fund's proprietary fund accounting and financial reporting practices are based on all applicable GASB pronouncements as well as the following pronouncements issued on, or before, November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARBs) of the Committee on Accounting Procedures.

Investments - The Department reports all investments at fair value except for certain nonparticipating fixed interest investment contracts which are valued using cost based measures. The fair value of investments is based on published market prices and quotations from major investment brokers and from the State of California for the Surplus Money Investment Fund. Uncommitted bond proceeds restricted for loans to veterans are reflected in the balance sheet as restricted cash and investments.

Receivables Under Contracts of Sale - Receivables under contracts of sale consist of the remaining contract principal balance net of the reserve for uncollectible accounts.

Allowance for Uncollectible Contracts - The allowance for uncollectible contracts is established through a provision charged to operations. The allowance is an amount that management believes will be adequate to absorb losses inherent in existing contracts and commitments to extend credit, based on evaluations of the collectibility and prior loss experience of contracts and commitments to extend credit. The evaluations take into consideration such factors as changes in the nature and volume of the portfolio, overall portfolio quality, specific problem contracts, commitments, and current and anticipated economic conditions that may affect the borrowers' ability to repay the obligation.

Contract Guarantees and Primary Mortgage Insurance – During 1998, the Department started collecting a contract guarantee fee on all contracts with down payments less than 20%. Such contracts are classified as high loan to value (HLTV) contracts. For eligible borrowers, the fee is used to purchase contract guarantees from the U.S. Department of Veterans Affairs (USDVA) or primary mortgage insurance. For certain HLTV contracts not eligible for USDVA guarantees, the Fund purchases primary mortgage insurance (PMI) from Radian Guaranty Inc., formerly, the Commonwealth Mortgage Assurance Company. The PMI provides lifetime coverage on the HLTV contracts, not covered by USDVA guarantees, subject to an aggregate 2% deductible. The Department is responsible for any losses not covered by the USDVA guarantees or the PMI.

Other Real Estate Owned - Real estate acquired by repossession is carried at the lower of the contract balance or its net realizable value. After repossession, the value of the underlying contract is written down to the estimated fair value of the real estate, if necessary. Any subsequent write-downs are charged against operating expenses. Operating expenses of such properties, net of any related income, are included in other expenses.

Insurance Claims Payable and Loss Reserves - Insurance claims payable and loss reserves include unpaid claims, incurred but not reported claims and loss reserves for the fire and hazard insurance plan and the remaining benefits payable under the Department's former self-insured life and disability protection plan.

Fire and Hazard Insurance - This insurance program is provided to eligible contract holders as part of the loan program. The difference between premiums charged to contract holders and claims and expenses incurred and the change in loss reserves is included as a net amount in the statement of revenues, expenses and changes in retained earnings.

Self-Insured Life and Disability Protection Plan - Beginning in 1984, the Department operated a self-funded protection plan whereby life and disability insurance was provided to eligible contract holders. This plan was terminated June 1, 1996. The life and disability benefits previously available to these members under the self-insured protection plan continue to be available to those contract holders who were receiving benefits at the time the plan was terminated. Loss reserves to satisfy these obligations of the protection plan which include future disability and life benefits were derived from an actuarial evaluation performed in 1997. Significant actuarial assumptions and methodologies used to calculate the reserve are interest, mortality, disability, prepayment, and a long-term discount rate of 7%.

Amortization of Bond Premiums, Discounts and Issuance Costs - Premiums and discounts arising from the issuance of bonds and expenses incurred in connection with the issuance of bonds are capitalized and amortized using the monthly amortization method, which approximates the interest method.

New Accounting Pronouncements – In June 1999, the Governmental Accounting Standards Board issued Statement of Governmental Accounting Standards (SGAS) No. 34, *Basis Financial Statements and Management's Discussion and Analysis for State and Local Governments.* The statement establishes financial reporting standards for certain governmental entities which will require expanded financial information, management discussion and analysis and certain supplemental information. This statement will be effective for the Department for the year ended June 30, 2002. The Department is in the process of determining what effect adopting SGAS No. 34 will have on the Fund's financial statements.

Reclassification - Certain 2000 amounts have been reclassified to conform with the 2001 presentation.

2. CASH AND INVESTMENTS

Cash in the State Treasury represents amounts held in the Fund's general operating accounts with the State Treasury. These monies are pooled with the monies of other State agencies and invested by the State Treasurer's office. These assets are not individually identifiable.

The cash overdrafts of $17,340,000 as of June 30, 2000 represented a liability due to the State Treasury.

Investment of bond funds is restricted by applicable California law and the various bond resolutions associated with each issuance, generally, to certain types of investments, including direct obligations of the U.S. Government and its agencies, the State of California's Surplus Money Investment Fund, and investment agreements with financial institutions or insurance companies rated within the top two ratings of a nationally recognized rating service. The investments with the insurance administrator, held as a deposit in accordance with a master agreement for the remaining active life and disability insurance program for disabled contract holders, is authorized by California law.

The Fund's investments in investment agreements totaling $319,476,000 as of June 30, 2001 are carried at cost. The interest rates on investment agreements are fixed and range from 5.30% to 7.055%. The investment agreements expire from 2001 to 2032.

All of the Fund's investments in U.S. Treasury notes and bonds, corporate bonds, and the amounts administered by the insurance company are categorized as risk category 1, which is defined by GASB Statement No. 3 as investments that are insured or registered or for which the securities are held by the Fund or its agent in the Fund's name. In accordance with GASB Statement No. 3, the Fund's investments held in the State of California's Surplus Money Investment Fund, the investment agreements and the mutual fund are not categorized as to risk.

The Fund's investments at June 30, 2001 and 2000 are as follows (in thousands):

	2001	2000
Category 1		
U.S. Treasury notes and bonds		$112,107
Amounts held in trust fund with insurance administrators:		
U.S. Treasury notes	$ 1,676	5,433
Corporate bonds	11,207	7,441
Other	3,950	10,452
Investments Not Subject to Categorization		
State of California's Surplus Money Investment Fund	303,765	226,076
Investment agreements (at cost)	319,476	562,380
Amounts held in trust fund with insurance administrators:		
Mutual fund (Vanguard)	1,306	1,534
Total	$641,380	$925,423

3. **RECEIVABLES UNDER CONTRACTS OF SALE**

The Fund retains title to all real property subject to contracts of sale until the contract is satisfied. The veteran's contracts have original terms of 25-30 years and bear interest at rates of 4.4% to 9.75%, depending on the age and type of contract and the classification of the current contract holder. During 1998, the Department lowered the rate on most of the existing contracts of purchase from 8.0% to 6.95%.

4. **BONDS PAYABLE**

At June 30, 2001 and 2000, bonds payable included the following (in thousands):

	2001	2000
General obligation bonds of the State of California, annual interest rates from 3.6% to 11.0% due in varying annual installments through 2032 (subject to varying redemption provisions)	$2,415,765	$2,528,330
Home purchase revenue bonds, annual interest rates from 4.05% to 6.15%, due in varying annual installments through 2028 (subject to varying redemption provisions)	570,940	505,815
Total	2,986,705	3,034,145
Discounts	(3,185)	(4,048)
Unamortized bond origination costs	(16,424)	(13,417)
Unamortized bond redemption premiums	(6,628)	(7,569)
Total	$2,960,468	$3,009,111

Future scheduled bond maturities at June 30, 2001 are as follows (in thousands):

2002	$ 73,330
2003	76,010
2004	107,115
2005	120,705
2006	138,145
Thereafter	2,471,400
Total	$2,986,705

General obligation bonds of the State of California are payable in accordance with the various veterans bond acts by the State General Fund. The full faith and credit of the State of California is pledged for the payment of both principal and interest. All general obligation bonds have an equal claim against the General Fund of the State of California. These bonds are included as obligations of the Fund when the proceeds from bond sales are received. The repayment for the bonds is the responsibility of the Fund. Authorized and unissued bonds under the Veterans Bond Acts of 1996 and 2000 at June 30, 2001 and 2000 were $605,585,000 and $176,835,000, respectively.

Home Purchase Revenue bonds are special obligations of the Department payable solely from, and by a pledge of, an undivided interest in the assets of the Veterans Farm and Home Building Fund of 1943 and the Veterans Debenture Revenue Fund, a separate fund of the Department. The undivided interest in the net revenues of the 1943 Fund is secondary and subordinate to any interest or right in the 1943 Fund of the people of the State of California and of the holders of general obligation veterans bonds. At any point in time, authorized and unissued revenue bonds equal the $1.5 billion ceiling authorized in 1987 less revenue bonds outstanding at that time. At June 30, 2001 and 2000, authorized and unissued revenue bonds were $929,060,000 and $994,185,000, respectively.

During fiscal year 1998, the Department amended the revenue bond resolution provisions regarding the Bond Reserve Account in the Veterans Debenture Revenue Fund (a separate entity). The revenue bond resolution requires the establishment and maintenance of a Bond Reserve Account in an amount equal to at least three percent of the aggregate outstanding principal amount of all Revenue Bonds with interest rates fixed to maturity. To calculate the reserve requirement, the Ninth Supplemental Resolution established, with respect to the revenue bonds with interest rates fixed to maturity issued pursuant to such resolution (1997 Series A, B and C Bonds, 1998 Series A Bonds, 1999 Series A and B Bonds, 2000 Series A, B and C Bonds, and 2001 Series A Bonds), a requirement equal to at least seven percent of the outstanding principal amount of such Revenue Bonds. Amounts in the Bond Reserve Account shall be used solely for the purposes of paying the principal of and the interest on the Revenue Bonds and for making Mandatory Sinking Fund Account Payments on Revenue Bonds. Amounts on deposit in the Bond Reserve Account as of any date, in excess of the bond reserve requirement, may be transferred out of the Veterans Debenture Revenue Fund to the Fund, at the request of the Department. Investment earnings of the Veterans Debenture Revenue Fund are transferred to the Fund. At June 30, 2001 and 2000, the total assets of the Veterans Debenture Revenue Fund are shown as a receivable of the Fund. Complete financial statements of the Veterans Debenture Revenue Fund, Department of Veterans Affairs, State of California can be obtained by contacting the California Department of Veterans Affairs.

5. BOND REFUNDING

During fiscal year 2001, the Department issued General Obligation bonds totaling $358,625,000 and Home Purchase Revenue bonds totaling $179,570,000 with an average interest rate of 5.37%. Bond proceeds from the General Obligation bond issues and proceeds from the Home Purchase Revenue bond issues were used to refund previously issued General Obligation bonds of $434,255,000 and Revenue bonds of $103,940,000.

For those bonds that could not be called for immediate redemption, approximately $10,895,000 is deposited in an escrow account held by the State Treasurer, as escrow trustee, to provide for all future debt service payments on the defeased bonds. As a result, these bonds are considered to be defeased and the liability for those bonds is not included in the Fund's balance sheet.

The Department decreased its total debt service payments over the next 15 years by approximately $189,400,000 and realized an economic gain (difference between the present values of the debt service payment on the old and new debt adjusted by additional cash paid) of approximately $19,643,000 in connection with the refunding.

During the 2001 fiscal year, the escrow trustee retired approximately $6,400,000 of bonds which were considered defeased as of June 30, 2000.

6. FIRE AND HAZARD INSURANCE

Fire and hazard insurance coverage is provided on behalf of contract holders for substantially all properties subject to contracts of sale. The program is funded by amounts charged to contract holders which are considered appropriate to cover losses incurred, premiums paid for excess insurance coverage and administration fees. From the amounts charged to contract holders, the Department pays losses up to $1,500,000 per occurrence or $12,000,000 per policy year. Coverage in excess of the above amounts is provided under a master policy with an insurance carrier which also administers the program. The loss reserve is based on the third party administrators estimate of incurred but not reported claims based on the historical trends and loss experience within the portfolio.

The excess of premiums charged to contract holders over claims, expenses and change in loss reserves for the year ended June 30, 2001 and 2000 was as follows (in thousands):

	2001	2000
Amounts charged to contract holders	$9,772	$8,768
(Less) plus:		
(Increase) decrease in estimated loss reserve	221	115
Claims loss expense	(6,186)	(6,475)
Master policy premium	(549)	(469)
Administrative fees	(472)	(531)
Excess of amounts charged to contract holders over claims and expenses and changes in reserves	$2,786	$1,408

7. SELF-INSURED LIFE AND DISABILITY PROTECTION PLAN

The Department was responsible for a self-insured life and disability protection plan for all contract holders until June 1, 1996. At that time, except for contract holders receiving benefits, the self-insured life and disability protection plan was replaced by an interim life and disability insurance plan provided by a commercial insurer, Pacific Life Insurance (PLI). Effective February 1, 1998, PLI was selected to provide a replacement, long-term life and disability plan.

As of June 30, 2001, the Department remains self-insured for approximately 737 remaining contract holders. Under the provisions of the self-insured plan benefits continue until the beneficiary returns to active employment, dies or their contract is paid off. Loss reserves for these obligations have been actuarially determined. A portion of the required loss reserves are maintained under a third party administrator (TPA) agreement and are shown in the financial statements as investments with insurance administrators. During the year, the TPA reserves have been used to satisfy benefits payable under the self-insured protection plan. Earnings on investments held by the TPA were $1,175,589 and $1,350,145 in 2001 and 2000, respectively, and are included in interest revenues - investments and other in the financial statements.

The excess of claims expenses, changes in loss reserves, and administrative expenses over plan revenues whose coverages continue as obligations of the self-funded life and disability protection plan for the years ended June 30, 2001 and 2000 was as follows (in thousands):

	2001	2000
Claims expenses:		
Life insurance program	$ (133)	$ (2,220)
Disability insurance program	(8,371)	(10,456)
Total claims expenses	(8,504)	(12,676)
Decrease in estimated loss reserves	4,917	8,109
Net claims expenses and change in loss reserves	(3,587)	(4,567)
Plus plan revenues:		
Life insurance program	91	94
Disability insurance program	133	134
Total	224	228
Less administrative fees	(281)	(422)
Excess (deficiency) of plan revenues over net claims expense	$ (3,644)	$ (4,761)

8. COMMITMENTS AND CONTINGENCIES

As of June 30, 2001 and 2000, the Fund had loan commitments to veterans for the purchase of properties under contracts of sale of approximately $30,255,000 and $369,507,830, respectively.

The Department is a defendant in certain litigation related to the Department's former Self-Insured Life and Disability Protection Plan, and other matters. The Department, based on the advice of its counsel, believes that the suits are without merit and intends to vigorously defend its position. Management is of the opinion that the potential liability will not have a material adverse effect on the financial statements.

The Fund leases several buildings used as district offices. Rent expense for the years ended June 30, 2001 and 2000 was $415,271 and $445,083, respectively. Lease terms generally range from five to ten years with options to renew for additional periods. As of June 30, 2001, minimum annual rentals under operating leases are as follows (in thousands):

2002	$ 266,192
2003	184,413
2004	171,485
2005	68,089
Thereafter	
Total	$ 690,179

9. RETIREMENT PLAN

The Fund, through the Department and the State of California, contributes to the California Public Employees Retirement System (CalPERS), which includes an agent multiple-employer public employee retirement system and a cost sharing multiple-employee plan that acts as a common investment and administrative agent for participating entities within the State of California. Substantially all full-time employees of the Department, whose compensation is paid from the Fund, are members of CalPERS. The Plan provides a monthly allowance based on age, years of credited service, and highest average compensation over an established period of time of one to three years. Vesting occurs after five to ten years. The Plan also provides death and disability benefits. The benefits are established by contract with CalPERS in accordance with the provisions of the Public Employees Retirement Law. CalPERS issues a publicly available Comprehensive Annual Financial Report (CAFR) that includes financial statements and required supplementary information for CalPERS. A copy of that report may be obtained by writing to CalPERS, Central Supply, P.O. Box 1802, Sacramento, CA 95812-1802.

Contributions to the Plan are funded by both the Department and the employee, and are actuarially determined by CalPERS based on covered compensation. State employees, with the exception of employees in the second-tier plan, are required to contribute to the fund. The contribution rates of active plan members are based on a percentage of salary over a monthly base compensation amount of $238 to $863. With the exception of employees in the second-tier plan, state employees' required contributions vary from 5% to 8% of their salary over their base compensation amount.

Contributions by the Department to the Plan for the years ended June 30, 2001 and 2000 were approximately $116,000 and $98,000, or approximately 3.8% and 5.6% of participants' salaries, respectively. Employee contributions to the Plan for the years ended June 30, 2001 and 2000 were approximately $377,000 and $378,000 or approximately 3.1% and 4.1% of participants' salaries, respectively.

For fiscal years ended June 30, 2001 and 2000, the Department's annual pension cost was equal to the Department's required and actual contributions. The required contribution was determined as part of the June 30, 1997 actuarial valuation using the entry age normal actuarial cost method. The actuarial assumptions included (a) 8.25% investment rate of return, and (b) projected salary increases that vary by duration of service. Both (a) and (b) included an inflation component of 3.5%. The actuarial value of the Department's assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a five-year period. The unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll on a closed basis. The remaining amortization period at June 30, 1997 was 32 years. Three-year fund trend information is as follows:

Three-Year Fund Trend Information

Fiscal Year End	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
June 30, 1999	$ 625,000	100%	$ -
June 30, 2000	$ 98,000	100%	$ -
June 30, 2001	$ 116,000	100%	$ -

The most recent actuarial valuation of CalPERS indicated that there was an unfunded liability for vested benefits due current employee participants in the plan. The amount of the unfunded liability applicable to each agency or department cannot be determined. Trend information, which presents CalPERS progress in accumulating sufficient assets to pay benefits when due is presented in the June 30, 1998 CalPERS CAFR.

Since all state agencies and departments are considered by CalPERS collectively as a single employer, the actuarial value of plan assets, the actuarial accrued liability, the total unfunded liability, the actuarial value of assets as a percentage of the actuarial accrued liability, and the ratio of unfunded actuarial liability to annual covered payroll attributable to the Department's employees, whose compensation is paid from the Fund, cannot be determined.

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EXHIBIT 2

CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA

Contracts of Purchase

Set forth below is certain financial information regarding Contracts of Purchase.

Existing Contracts of Purchase

The following charts describe the current loan to value ratios and geographic distribution of Contracts of Purchase financed under the Program as of September 30, 2001 using proceeds of Veterans G.O. Bonds, Revenue Bonds and other amounts under the 1943 Fund.

Current Loan-to-Value Ratio of Contracts of Purchase[1][2]

	Uninsured	Radian Insured[5]	Radian Insured[6]	In Process for Radian Insurance	VA Guaranteed	Total
Single Family Homes						
Less than 30% LTV	$ 107,227	$ 116	$ 30	--	$ 120	$ 107,493
30-49% LTV	247,584	748	72	--	350	248,754
50-59% LTV	166,047	1,154	--	--	178	167,379
60-69% LTV	202,964	6,510	145	--	556	210,175
70-79% LTV	220,082	81,978	321	--	2,646	305,027
Sub-total	$ 943,904	$ 90,506	$ 568	--	$ 3,850	$ 1,038,828
80-84% LTV	$ 21,452	$ 148,409	$ 18,129	--	$ 9,081	$ 197,071
85-89% LTV	28,319	248,612	56,850	$ 1,864	26,594	362,239
90-94% LTV	45,380	94,815	118,553	6,042	80,081	344,871
95-97% LTV	34,273	797	134,989	12,343	77,049	259,451
Sub-total	$ 129,424	$ 492,633	$ 328,521	$ 20,249	$ 192,805	$ 1,163,632
Greater than 97% LTV	$ 35,132	$ 1,388	$ 112,799	$ 369	$ 157,437	$ 307,125
Other Property Types						
Farms	$ 5,552	$ 199	--	--	--	$ 5,751
Mobile Homes in Parks	8,303	--	$ 192	--	--	8,495
Sub-total	$ 13,855	$ 199	$ 192	--	--	$ 14,246
Special Status Contracts of Purchase						
Real Estate Owned[3]	$ 9,852	$ 3,616	$ 569	--	$ 139	$ 14,176
Disability Program[4]	21,763	--	1,518	--	--	23,281
Sub-total	$ 31,615	$ 3,616	$ 2,087	--	$ 139	$ 37,457
Total Portfolio	$ 1,153,930	$ 588,342	$ 444,167	$ 20,618	$ 354,231	$ 2,561,288

(1) 000's omitted
(2) LTV based on current Contracts of Purchase balance divided by original appraised value of the property, except that the Department updates the appraised value of the home when the veteran applies for a home improvement loan. In such cases, the LTV is calculated with the new appraised value.
(3) Repossessed properties and delinquent Contracts of Purchase carried as REO on financial statements.
(4) Contracts of Purchase where payments are made on behalf of veterans by the Department's life and disability coverage plan.
(5) The policy was executed on February 28, 1998.
(6) The policy was executed on July 1, 2000.

Geographic Distribution of Contracts of Purchase

County	Approximate Current Contract Balance
San Diego	$ 289,828,868
Sacramento	264,678,476
Los Angeles	184,465,545
San Bernardino	169,179,797
Riverside	161,879,421
Fresno	115,360,490
Orange	114,979,902
Kern	101,449,614
Solano	96,820,765
Placer	88,909,092
San Joaquin	74,720,807
Shasta	64,315,791
Contra Costa	60,448,103
Other Northern California Counties	402,508,887
Other Central California Counties	270,621,414
Other Southern California Counties	101,121,058
Statewide--California	$ 2,561,288,030

Contracts of Purchase Origination and Principal Repayment Experience

The following tables represent, respectively, a historical picture of Contract of Purchase originations since the 1985 fiscal year and selected principal repayments with respect to Contracts of Purchase since the 1985 fiscal year.

New Contracts of Purchase During the Fiscal Year(1)

Fiscal Year Ending June 30	Veterans G.O. Bonds		Unrestricted Funds		Revenue Bonds		Total	
	Number	Amount	Number	Amount	Number	Amount	Number	Amount
1985	4,196	$ 290,885,900			2,301	$ 154,244,600	6,497	$ 445,130,500
1986	3,484	243,955,800			2,401	160,782,200	5,885	404,738,000
1987	1,569	108,789,700			1,160	75,836,800	2,729	184,626,500
1988	2,958	236,054,500			1,397	99,040,900	4,355	335,095,400
1989	3,112	252,796,300			1,154	83,076,100	4,266	335,872,400
1990	2,097	187,445,600			522	38,150,800	2,619	225,596,400
1991	1,927	200,393,500			359	29,189,600	2,286	229,583,100
1992	1,086	111,600,500			388	34,671,600	1,474	146,272,100
1993	740	94,417,100			286	27,443,800	1,026	121,860,900
1994	843	117,213,779			337	34,740,536	1,180	151,954,315
1995	2,109	286,178,376			822	84,860,894	2,931	371,039,270
1996	762	107,751,444			222	22,723,617	984	130,475,061
1997	766	118,344,636			201	21,853,933	967	140,198,569
1998	615	99,224,002	188	$ 17,716,376	164	18,871,066	967	135,811,444
1999	758	129,521,359	575	92,728,280	274	33,284,343	1,607	255,533,982
2000	1,045	185,180,534	1,725	333,328,690	708	92,214,409	3,478	610,723,633
2001	844	135,498,480	1,211	232,445,146	697	101,175,512	2,752	469,119,138
2002(2)	73	12,655,406	72	10,642,694	58	7,551,039	203	30,849,139

(1) Number of new Contracts of Purchase does not include home improvement loans.
(2) 3-month period through September 30, 2001.

Selected Principal Flows with respect to Contracts of Purchase Funded by both Veterans G.O. Bonds and Revenue Bonds

Fiscal Year Ending June 30	Contracts Funded During Year (000s)	Contract Prepayments During Year (000s)	Other Principal Receipts-Losses During Year (000s)	Contract Balance at End of Year (000s)	Average Rate on all Outstanding Contracts	Average of Monthly FHLMC 30-year Conventional Loan Rate	Annual Average Prepayment Rate	Annual Average Origination Rate
	Principal Flows				Rates			
1985	$ 445,131	$ 123,669	$ 88,308	$ 3,142,526	8.0%	13.8%	4.1%	14.7%
1986	404,738	179,809	94,970	3,272,485	8.0	11.5	5.6	12.6
1987	184,627	261,675	99,569	3,095,868	7.7	9.8	8.2	5.8
1988	335,095	198,396	114,178	3,118,389	7.0	10.5	6.4	10.8
1989	335,872	207,471	105,896	3,140,894	7.3	10.6	6.6	10.7
1990	225,596	232,085	96,639	3,037,766	8.0	10.1	7.5	7.3
1991	229,583	191,895	92,722	2,982,732	8.0	9.9	6.4	7.6
1992	146,272	246,150	92,975	2,789,879	8.0	9.0	8.5	5.1
1993	121,861	273,817	105,629	2,532,294	8.0	8.0	10.3	4.6
1994	151,954	359,749	98,773	2,225,726	8.0	7.3	15.1	6.4
1995	371,039	111,984	74,706	2,410,075	7.8	8.7	4.8	16.0
1996	130,475	141,767	92,521	2,306,262	8.0	7.5	6.0	5.5
1997	140,199	111,254	106,027	2,229,180	8.0	7.9	4.9	6.2
1998	135,811	172,134	94,106	2,098,752	7.7	7.2	8.0	6.3
1999	255,534	183,776	101,254	2,069,256	6.9	6.9	8.8	12.3
2000	610,724	138,401	106,522	2,435,056	6.8	8.1	6.1	27.1
2001	469,119	189,902	91,033	2,623,241	6.8	7.5	7.5	18.5
2002(1)	30,849	70,399	22,403	2,561,288	6.8	7.0	10.9	4.8
	$ 4,724,479	$ 3,394,333	$ 1,678,231					

Reservation rates on new Contracts of Purchase for period:

Period	Veterans G.O. Bonds*	Unrestricted Funds*	Revenue Bonds*
Prior to January 1, 1999, substantially all newly originated Contracts have the same rate as the then outstanding Contracts.			
January 1, 1999 thru June 30, 2000	6.65%	6.65%	5.95%
July 1, 2000 thru February 28, 2001	7.50%	7.95%	6.95%
March 1, 2001 thru May 31, 2001	6.50%	7.95%	6.40%
June 1, 2001 thru August 31, 2001	6.50%	7.10%	6.40%
September 1, 2001 thru present	6.25%	6.50%	6.00%

* Rates for contracts of purchase for mobile home in parks shall be 1% higher than the applicable established rates.

(1) 3-month period through September 30, 2001.

Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments

The following table shows amounts expected to become available to fund Contracts of Purchase following the expected Veterans G.O. Bonds and Revenue Bonds issuances described in this Official Statement (the "Winter 2001 Transactions"). The universe of veterans eligible to receive Contracts of Purchase financed by the different classifications of available moneys is described under "THE PROGRAM--Qualifying Veteran Status." (This section appears in Appendix B in the official statement relating to Veterans G.O. Bonds and in the body of the official statement relating to Revenue Bonds.) Additional moneys may become available to finance Contracts of Purchase through the future issuances of Veterans G.O. Bonds and Revenue Bonds. The Department has full discretion to use moneys available from prior, current or future bond issues in any order of priority it chooses. As of October 31, 2001, the Department had 266 pending applications for Contracts of Purchase in the aggregate amount of approximately $40,000,000.

			Respective Series Bond Proceeds Subaccounts				
Bond Series	**Deposit as of**	**Balance as of**	**Unrestricted Moneys[1]**	**Qualified Veterans Mortgage Bond Proceeds[1]**	**Qualified Mortgage Bond Proceeds[1]**	**Investment**	**Investment Rate (%)**
Veterans G.O. Bond Proceeds Subaccounts							
Series BP		9/30/01	-0-	$ 3,026	-0-	SMIF[3]	Variable
Series BJ 11/12		9/30/01	-0-	79,613	-0-	AIG[8]	6.481
Series BT/BU		9/30/01	-0-	11,941	-0-	SMIF[3]	Variable
Series BV/BW		9/30/01	-0-	85,131	-0-	SMIF[3]	Variable
Series BX		9/30/01	-0-	6,243	-0-	SMIF[3]	Variable
Series BY/BZ[12]	12/6/01		-0-	11,237	-0-	SMIF[3]	Variable
Sub-total			-0-	$ 197,191	-0-		
Veterans G.O. Bond Recycling Subaccounts							
Series BM/BN		9/30/01	$ 2,979	-0-	-0-	WestLB[5][11]	5.380
Series BM/BN		9/30/01	3,792	-0-	-0-	SMIF[3]	Variable
Unrestricted		9/30/01	75,081	-0-	-0-	SMIF[3]	Variable
Sub-total			$ 81,852	-0-	-0-		
Total Veterans G.O. Bonds			**$ 81,852**	**$ 197,191**	**-0-**		
Revenue Bonds Proceeds Subaccounts							
1997 C		9/30/01	-0-	-0-	$ 89,377	Trinity[10]	6.157
2001 A		9/30/01	$ 4,074	-0-	-0-	SMIF[3]	Variable
2002 A[13]	3/6/02		5,904	-0-	-0-	SMIF[3]	Variable
Sub-total			$ 9,978	-0-	$ 89,377		
Revenue Bonds Recycling Subaccounts							
Section 143		9/30/01	-0-	-0-	$ 2,028	Soc Gen[2][4]	5.730
1991 A Recycling		9/30/01	$ 8,362	-0-	-0-	BLB[6][11]	6.060
1999 A/B		9/30/01	12,514	-0-	-0-	BLB[7][11]	5.300
2000 A/B/C		9/30/01	9,000	-0-	-0-	WestLB[9][11]	6.460
Sub-total			$ 29,876	-0-	$ 2,028		
Total Revenue Bonds			**$ 39,854**	**-0-**	**$ 91,405**		
Grand Total			**$ 121,706**	**$ 197,191**	**$ 91,405**		

Footnotes are on the following page.

(1) 000's omitted.
(2) On August 18, 1999, Moody's confirmed the long-term rating (senior debt and deposits) of Societe Generale at Aa3 with a negative outlook.
(3) Surplus Money Investment Fund. Amounts invested in SMIF may be withdrawn and reinvested at any time.
(4) Investment agreement maturing December 1, 2001 with Societe Generale.
(5) Investment agreement maturing December 1, 2028 with Westdeutsche Landesbank Girozentrale.
(6) Investment agreement maturing December 1, 2009 with Bayerische Landesbank Girozentrale.
(7) Investment agreement maturing December 1, 2028 with Bayerische Landesbank Girozentrale.
(8) Investment agreement maturing December 1, 2002 with AIG Matched Funding Corporation ("AIG").
(9) Investment agreement maturing June 1, 2010 with Westdeutsche Landesbank Girozentrale.
(10) Investment agreement maturing December 1, 2002 with Trinity Plus Funding Company, LLC ("Trinity"). Under certain circumstances, Trinity will have the benefits of a letter of credit from General Electric Capital Corporation ("GE Capital") and of a revolving liquidity facility under which GE Capital is a lender (there can be additional lenders under the liquidity facility). However, the aggregate of the amounts available under the letter of credit and the liquidity facility may be significantly less than Trinity's obligations under its investment agreements.
(11) Both S&P and Moody's have announced negative rating outlooks for these banks.
(12) Part of the Winter 2001 Transactions, referred to in the official statement with respect to Veterans G.O. Bonds as the "Offered Veterans G.O. Bonds" and in the official statement with respect to Revenue Bonds as the "Winter 2001 Veterans G.O. Bonds".
(13) Part of the Winter 2001 Transactions, referred to in the official statement with respect to Revenue Bonds as the "Offered Revenue Bonds" and in the official statement with respect to the Veterans G.O. Bonds as the "Winter 2002 Revenue Bonds".

Cancellations and Delinquencies

Set forth in the table below is a comparative chart of delinquent, cancelled and repossessed Contracts of Purchase and certain comparative information regarding USDVA guaranteed loans during the same period.

	1994(1)	1995(1)	1996(1)	1997(1)	1998(1)	1999(1)	2000(2)	2001(2)	2002(3)
Percentage of Number of Contracts of Purchase Delinquent									
30-60 days(6)	--(7)	--(7)	--(7)	--(7)	--(7)	--(7)	3.27%	3.54%	3.61%
60+ days(6)	--(7)	--(7)	--(7)	--(7)	--(7)	--(7)	2.08%	1.80%	1.54%
Cancelled Contracts and Real Estate in inventory(4)	--(7)	--(7)	--(7)	--(7)	--(7)	--(7)	0.49%	0.70%	0.61%
USDVA Guaranteed Loans(5)									
Percentages in U.S.									
Delinquent									
30-60 days	4.07%	4.14%	4.59%	4.54%	4.45%	4.35%	4.19%	4.71%	
60+ days	2.25%	2.21%	2.20%	2.21%	2.35%	2.26%	2.25%	2.65%	
Foreclosures in inventory	1.44%	1.26%	1.54%	1.81%	1.77%	1.82%	1.44%	1.20%	
Percentages in California									
Delinquent									
30-60 days	3.42%	4.03%	4.23%	4.30%	4.28%	4.13%	4.05%	4.57%	
60+ days	2.36%	2.53%	2.36%	2.52%	2.61%	2.45%	2.27%	2.49%	
Foreclosures in inventory	2.28%	2.31%	3.18%	3.54%	2.92%	2.28%	1.39%	0.93%	

(1) As of June 18 for Department's and as of June 30 for USDVA data.
(2) As of June 30 for Department's and USDVA data.
(3) As of September 30, 2001 for Department's and as of June 30, 2001 for USDVA data.
(4) Bankruptcies are included in cancelled Contracts statistics and do not exceed in any period more than 10% of total cancellations and bankruptcy category. Federal bankruptcy law precludes repossession action of Contracts of Purchase when veteran is in bankruptcy proceedings until the automatic stay is lifted.
(5) Source: National Delinquency Survey published by the Mortgage Bankers Association of America.
(6) As of the June 30, 1999 installation of the Integrated Loan Processing and Financial Information System, the Department reports delinquencies on a basis consistent with industry standards.
(7) The data below represents the Department's reporting method prior to the implementation of the Integrated Loan Processing and Financial Information System.

	1994(1)	1995(1)	1996(1)	1997(1)	1998(1)	1999(1)
Percentage of Number of Contracts of Purchase Delinquent(7)						
40-67 days	0.99%	1.45%	2.90%	1.65%	0.78%	0.87%
68+ days	4.24%	3.12%	2.50%	3.22%	1.99%	1.34%
Cancelled Contracts and Real Estate in inventory(4)	0.73%	1.28%	1.89%	1.86%	1.49%	0.94%

Veterans G.O. Bonds and Revenue Bonds

The chart below sets forth certain information regarding Veterans G.O. Bonds and Revenue Bonds, including those expected to be redeemed as a result of the issuance Veterans G.O. Bonds and/or Revenue Bonds as part of the Winter 2001 Transactions.

Selected Information with Respect to Veterans G.O. Bonds and Revenue Bonds

Series	Bonds Outstanding as of 8/1/01	Bonds Expected to be Outstanding as of 6/1/02	Final Maturity Date of Series	Next Optional Call Date	Call Price on Such Date	Maximum Coupon Subject to Optional Call	Bonds Subject to Special Redemption[9]
Veterans G.O. Bonds Issued to Refund Bonds Issued Prior to the Mortgage Subsidy Bond Tax Act of 1980							
BM	$ 53,385,000	$ 53,385,000	December 1, 2025	--[1]	--[1]	5.450%	Excess Revenues
BN2-4	71,250,000	71,250,000	December 1, 2028	--[1]	--[1]	5.450%	Excess Revenues
Sub-total	$ 124,635,000	$ 124,635,000					
Veterans G.O. Bonds Issued as Qualified Veterans Mortgage Bonds under the 1954 Code							
AK	9,000,000	$ 7,500,000	April 1, 2007	Non-callable	N.A.	N.A.	No
AL	26,000,000	20,000,000	April 1, 2007	Non-callable	N.A.	N.A.	No
AM	46,000,000	39,000,000	October 1, 2008	Non-callable	N.A.	N.A.	No
AN/AP	75,000,000	67,500,000	April 1, 2009	Non-callable	N.A.	N.A.	No
AQ	75,000,000	67,500,000	October 1, 2008	Non-callable	N.A.	N.A.	No
AR	34,000,000	29,000,000	October 1, 2009	Non-callable	N.A.	N.A.	No
AS	38,000,000	37,000,000	October 1, 2009	Non-callable	N.A.	N.A.	No
AT	165,325,000	150,225,000	February 1, 2010	Non-callable	N.A.	N.A.	No
AU	113,120,000	103,510,000	October 1, 2010	Non-callable	N.A.	N.A.	No
AV	77,345,000	70,820,000	October 1, 2010	Non-callable	N.A.	N.A.	No
Sub-total	$ 658,790,000	$ 592,055,000					
Veterans G.O. Bonds Issued as Qualified Veterans Mortgage Bonds under the 1986 Code							
BC/BF[2]	$ 211,245,000	$ 99,920,000	February 1, 2027	--[4]	100%	6.375%	Allocated Prepayments[3]
BG/BH	586,355,000	584,255,000	December 1, 2032	--[5]	--[5]	5.600%[5]	Excess Revenues
BJ7/8	60,000,000	60,000,000	December 1, 2032	--[6]	--[6]	6.200%[6]	Excess Revenues
BJ9/10	40,000,000	40,000,000	December 1, 2032	--[7]	--[7]	6.050%[7]	Excess Revenues
BK/BL	255,615,000	255,615,000	December 1, 2012	--[5]	--[5]	5.300%[5]	Excess Revenues
BP/BN1	14,000,000	14,000,000	December 1, 2026	--[1]	--[1]	5.500%[1]	Excess Revenues /Unexpended
BQ/BR	80,000,000	80,000,000	December 1, 2029	June 1, 2004	101%	5.300%	Excess Revenues
BS	26,500,000	26,500,000	December 1, 2008	Non-callable	N/A	N/A	Excess Revenues
BJ11/12[8]	115,000,000	115,000,000	December 1, 2032	--[8]	--[8]	5.700%	Excess Revenues/Unexpended
BT/BU	115,400,000	115,400,000	December 1, 2026	December 1, 2005	101%	5.650%	Excess Revenues
BV/BW	86,225,000	86,225,000	December 1, 2032	June 1, 2006	101%	5.700%	Excess Revenues /Unexpended
BX	42,000,000	42,000,000	December 1, 2032	June 1, 2006	101%	5.500%	Excess Revenues
BY/BZ[10]	--	111,325,000	December 1, 2024	June 1, 2007	101%	5.375%	Excess Revenues /Unexpended
Sub-total	$ 1,632,340,000	$ 1,630,240,000					
TOTAL VETERANS G.O. BONDS	$ 2,415,765,000	$ 2,346,930,000					

Series	Bonds Outstanding as of 8/1/01	Bonds Expected to be Outstanding as of 6/1/02	Final Maturity Date of Series	Next Optional Call Date	Call Price on Such Date	Maximum Coupon Subject to Optional Call	Bonds Subject to Special Redemption[9]
Revenue Bonds Issued as Qualified Mortgage Bonds under the 1986 Code							
1997 A/B	$ 20,225,000	$ 19,930,000	December 1, 2028	December 1, 2008	101%	5.500%	Excess Revenues
1997 C	97,130,000	94,030,000	December 1, 2019	January 9, 2011	101%	5.500%	Excess Revenues /Unexpended
1998 A	113,690,000	104,110,000	December 1, 2019	December 1, 2008	101%	5.450%	Excess Revenues
Sub-total	$ 231,045,000	$ 218,070,000					
Revenue Bonds Issued to Refund Bonds Issued Prior to Mortgage Subsidy Bond Tax Act of 1980							
1999 A	$ 54,170,000	$ 54,170,000	December 1, 2027	June 1, 2004	101%	5.200%	Excess Revenues
1999 B	86,085,000	86,085,000	December 1, 2028	June 1, 2004	101%	5.200%	Excess Revenues
2000 A	54,000,000	--					
2000 B	63,200,000	--					
2000 C	42,600,000	42,600,000	December 1, 2027	June 1, 2005	101%	6.150%	Excess Revenues
2001 A	39,840,000	39,840,000	December 1, 2028	June 1, 2006	101%	5.600%	Excess Revenues /Unexpended
2002 A[11]	--	117,200,000	December 1, 2027	June 1, 2012	101%	5.350%	Excess Revenues /Unexpended
Sub-total	$ 339,895,000	$ 339,895,000					
TOTAL REVENUE BONDS	$ 570,940,000	$ 557,965,000					
TOTAL ALL BONDS	$ 2,986,705,000	$ 2,904,895,000					

(1) The Series BM Bonds and Series BN Bonds maturing on and before December 1, 2004 are subject to optional redemption at par on and after June 1, 2000. The remaining Series BM Bonds and Series BN Bonds and all of the Series BP Bonds are subject to optional redemption on and after December 1, 2003, initially at 101% of the principal amount thereof, declining to par on and after December 1, 2004.

(2) Series BC/BF includes Series BC, Series BD, Series BE and Series BF.

(3) Subject to redemption at par from a portion of prepayments on all Contracts of Purchase as allocated to Series based on periodically determined ratio of outstanding bonds (including Veterans G.O. Bonds and Revenue Bonds) of Series to all outstanding bonds. Series BC/BF is now subject to optional redemption at par.

(4) The Series BC/BF Bonds are subject to optional redemption prior to their respective stated maturity dates, in whole on the first day of any month, or in part on any interest payment date.

(5) Except as described in the next sentence, the Series BG Bonds, Series BH Bonds, and Series BL Bonds are subject to optional redemption on and after December 1, 2008, initially at 101% of the principal amount thereof, declining to par on December 1, 2009. The Series BH Bonds maturing on December 1, 2018, December 1, 2024, and December 1, 2032 are subject to optional redemption on and after December 1, 2003 at 102% of the principal amount thereof, declining to 101% of the principal amount thereof on and after December 1, 2004, and declining further to par on December 1, 2005. The Series BK Bonds are not subject to

optional redemption.

(6) The BJ-7/8 Serial Bonds maturing on December 1, 2010 through and including December 1, 2016 are subject to optional redemption on December 1, 2009, initially at 101% of the principal amount thereof, declining to par on and after December 1, 2010. The BJ-7/8 Term Bonds maturing on December 1, 2018, December 1, 2024 and December 1, 2032 are subject to optional redemption on December 1, 2005, initially at 102% of the principal amount thereof, declining to par on and after December 1, 2007.

(7) The BJ-9/10 Serial Bonds maturing on December 1, 2010 through and including December 1, 2016 are subject to optional redemption on April 27, 2010, initially at 101% of the principal amount thereof, declining to par on and after April 27, 2011. The BJ-9/10 Term Bonds maturing on December 1, 2018, December 1, 2024 and December 1, 2032 are subject to optional redemption on April 27, 2006, initially at 102% of the principal amount thereof, declining to par on and after April 27, 2008.

(8) The BJ-11/12 Serial Bonds maturing on December 1, 2011 through and including December 1, 2016 are subject to optional redemption on December 19, 2010, initially at 101% of the principal amount thereof, declining to par on and after December 19, 2011. The BJ-11/12 Term Bonds maturing on December 1, 2018, December 1, 2024 and December 1, 2032 are subject to optional redemption on December 19, 2006, initially at 102% of the principal amount thereof, declining to par on and after December 19, 2008.

(9) Excess Revenues includes principal prepayments.

(10) Part of the Winter 2001 Transactions, referred to in the official statement with respect to Veterans G.O. Bonds as the "Offered Veterans G.O. Bonds" and in the official statement with respect to Revenue Bonds as the "Winter 2001 Veterans G.O. Bonds".

(11) Part of the Winter 2001 Transactions, referred to in the official statements with respect to Revenue Bonds as the "Offered Revenue Bonds" and in the official statement with respect to the Veterans G.O. Bonds as the "Winter 2002 Revenue Bonds".

Additional Investments

In addition to the investments described above under "Contracts of Purchase--Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments," the following investments have been made or will be made with respect to moneys in the 1943 Fund and in the Bond Reserve Account which secures the Revenue Bonds. Additional moneys in various Funds and Accounts in the 1943 Fund have been invested in SMIF. Amounts invested in SMIF may be withdrawn and reinvested at any time.

Bond Series	Account Designation[1]	Amount (000s)	Investment Provider[1]	Initial Investment Date	Investment Maturity Date	Interest Rate (%)
1997/1998	Reserve	$5,251[17]	Societe Generale[3]	3/26/98	12/1/28	5.75
1997/1998	Reserve	$7,001[2] [17]	U.S. Treasury	5/8/98	5/15/05	6.50
1999 A/B	Reserve	$9,817[17]	Westdeutsche Landesbank Girozentrale[9]	3/30/99	12/1/28	5.38
2000 A/B/C	Reserve	$10,186[17] [19]	Trinity Plus Funding Company, LLC	4/1/00	12/1/27	6.895
1997 C	Reserve	$5,733[17]	Westdeutsche Landesbank Girozentrale[9]	1/1/01	12/1/19	5.625
2002 A[16]	Reserve	$3,759[18]	Bayerische Landesbank Girozentrale[9]	3/6/02	12/1/27	5.38
BG/BH/BK /BL	Revenue/ Recycling	variable [4]	Societe Generale[3]	12/29/97	12/1/32	5.91
1997/1998	Revenue/ Restricted Recoveries	variable	Societe Generale[3]	3/26/98	12/1/28	5.91
BM/BN2-4	Revenue/ Recycling	variable [5]	Westdeutsche Landesbank Girozentrale[9]	5/5/98	12/1/28	5.38
BP/BN-1	Revenue/ Recycling	variable [5]	Westdeutsche Landesbank Girozentrale[9]	5/5/98	12/1/28	5.38
1999 A/B	Revenue/ Recycling	variable [6]	Bayerische Landesbank Girozentrale[9]	3/30/99	12/1/28	5.30
BQ/BR	Revenue/ Recycling	variable [7]	Westdeutsche Landesbank Girozentrale[9]	4/28/99	12/1/29	5.37
BJ 7/8	Revenue/ Recycling	variable[8]	Bayerische Landesbank Girozentrale[9]	12/1/99	12/1/32[8]	6.06
1991 A	Revenue/ Recycling	variable[8]	Bayerische Landesbank Girozentrale[9]	12/1/99	12/1/32[8]	6.06
2000 A/B/C[20]	Revenue/ Recycling	variable[10]	Westdeutsche Landesbank Girozentrale[9]	3/29/00	12/1/27[10]	6.46
BJ 9/10	Revenue/ Recycling	variable[11]	Westdeutsche Landesbank Girozentrale[9]	4/27/00	12/1/32[11]	6.46
BS	Revenue	variable[11]	Westdeutsche Landesbank Girozentrale[9]	4/27/00	12/1/32[11]	6.46
BJ 11/12	Revenue/ Recycling	variable[12]	Westdeutsche Landesbank Girozentrale[9]	12/19/00	12/1/32[12]	5.50
BT/BU	Revenue/ Recycling	variable[13]	Westdeutsche Landesbank Girozentrale[9]	12/19/00	12/1/26[13]	5.50
1997 C	Revenue/ Restricted Recoveries	variable[14]	Westdeutsche Landesbank Girozentrale[9]	1/9/01	12/1/19	5.50
BV/BW	Revenue/ Recycling	variable[15]	Bayerische Landesbank Girozentrale[9]	6/20/01	12/1/32[15]	5.67
2001 A	Revenue/ Recycling	variable[15]	Bayerische Landesbank Girozentrale[9]	6/20/01	12/1/32[15]	5.67
BX	Revenue/ Recycling	variable[15]	Bayerische Landesbank Girozentrale[9]	6/20/01	12/1/32[15]	5.67

Footnotes are on the following page.

1) Accounts are established in the resolutions authorizing the issuance of Revenue Bonds. All investments are investment agreements unless otherwise noted.
2) At cost. Invested in U.S. Treasury Bonds.
3) On August 18, 1999, Moody's confirmed the long-term rating (senior debt and deposits) of Societe Generale at Aa3 with a negative outlook.
4) Maximum permitted amount on deposit under investment agreement at any one time is $250,000,000.
5) Maximum permitted amount on deposit under investment agreement for all (BM, BN, and BP) subaccounts is $50,000,000.
6) Maximum permitted amount on deposit under investment agreement for both subaccounts is $75,000,000.
7) Maximum permitted amount on deposit under investment agreement for both subaccounts is $35,000,000.
8) Maximum permitted amount on deposit under investment agreement for all (BJ 7/8, and 1991 A) subaccounts is $25,000,000. Investment maturity date for the recycling subaccounts is December 1, 2009.
9) Both S&P and Moody's have announced negative rating outlooks for these banks.
10) Maximum permitted amount on deposit under investment agreement for both subaccounts is $20,000,000. Investment maturity date for the recycling subaccount is June 1, 2010.
11) Maximum permitted amount on deposit under investment agreement for all three (BJ 9/10, and BS) subaccounts is $20,000,000. Investment maturity date for BJ-9/10 G.O. Bond Series Recycling Subaccount is June 1, 2010.
12) Maximum permitted amount on deposit under investment agreement for both subaccounts is $25,000,000. Investment maturity date for BJ-11/12 G.O. Bond Series Recycling Subaccount is December 1, 2010.
13) Maximum permitted amount on deposit under investment agreement for both subaccounts is $20,000,000. Investment maturity date for BT/BU G.O. Bond Series Recycling Subaccount is December 1, 2010.
14) Maximum permitted amount on deposit under investment agreement for both subaccounts is $97,130,000.
15) Maximum permitted amount on deposit under investment agreement for all (BV/BW, 2001 A, BX) subaccounts is $25,000,000. Investment maturity date for all (BV/BW, 2001 A, BX) recycling subaccounts is December 1, 2011.
16) Part of the Winter 2001 Transactions, referred to in the official statements with respect to Revenue Bonds as the "Offered Revenue Bonds" and in the official statement with respect to the Veterans G.O. Bonds as the "Winter 2002 Revenue Bonds".
17) As of September 30, 2001.
18) As of March 6, 2002.
19) The amount will be reduced by approximately $7,471,000 upon the refunding of the 2000 Series A/B Revenue Bonds by the Winter 2002 Revenue Bonds.
20) The 2000 Series A/B Revenue Bonds are to be refunded in whole following the issuance of the Winter 2002 Revenue Bonds.

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APPENDIX C

DTC AND THE BOOK-ENTRY SYSTEM

The information in this Appendix concerning The Depository Trust Company ("DTC"), New York, New York, and DTC's book-entry system has been obtained from sources that the State Treasurer believes to be reliable, but the State Treasurer and the Underwriters take no responsibility for the accuracy or completeness thereof.

DTC will act as securities depository for the Offered Veterans G.O. Bonds. The Offered Veterans G.O. Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully registered Offered Veterans G.O. Bond certificate will be issued for each maturity of each Series of the Offered Veterans G.O. Bonds in the aggregate principal amount of such maturity, and will be deposited with DTC.

DTC is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934, as amended. DTC holds securities that its participants ("Direct Participants") deposit with DTC. DTC also facilitates the settlement among Direct Participants of securities transactions, such as transfers and pledges, in deposited securities through electronic computerized book-entry changes in Direct Participants' accounts, thereby eliminating the need for physical movement of securities certificates. Direct Participants include securities brokers and dealers, banks, trust companies, clearing corporations and certain other organizations. DTC is owned by a number of its Direct Participants and by the New York Stock Exchange, Inc., the American Stock Exchange, LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as securities brokers and dealers, banks and trust companies that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). The Rules applicable to DTC and its Direct and Indirect Participants are on file with the Securities and Exchange Commission.

Purchases of the Offered Veterans G.O. Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Offered Veterans G.O. Bonds on DTC's records. The ownership interest of each actual purchaser of each Offered Veterans G.O. Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase, but Beneficial Owners are expected to receive written confirmation providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Offered Veterans G.O. Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Offered Veterans G.O. Bonds, except in the event that use of the book-entry system for the Offered Veterans G.O. Bonds is discontinued.

To facilitate subsequent transfers, all Offered Veterans G.O. Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Offered Veterans G.O. Bonds with DTC and their registration in the name of Cede & Co., or such other DTC nominee, do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Offered Veterans G.O. Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Offered Veterans G.O. Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. The State Treasurer will not have any responsibility or obligation to such Direct Participants and Indirect Participants or the persons for whom they act as nominees with respect to the Offered Veterans G.O. Bonds.

Beneficial Owners of the Offered Veterans G.O. Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Offered Veterans G.O. Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Offered Veterans G.O. Bond documents. Beneficial Owners of the Offered Veterans G.O. Bonds may wish to ascertain that the nominee holding the Offered Veterans G.O. Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners.

Redemption notices shall be sent to DTC. If less than all of a maturity of a Series of the Offered Veterans G.O. Bonds is being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such maturity to be redeemed.

Neither DTC nor Cede & Co. (nor such other DTC nominee) will consent or vote with respect to Offered Veterans G.O. Bonds. Under its usual procedures, DTC mails an Omnibus Proxy to the State Treasurer as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Offered Veterans G.O. Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Without limiting the generality of the foregoing, the State Treasurer and the Underwriters have no responsibility or liability for any aspects of the records relating to or payments made on account of beneficial ownership, or for maintaining, supervising or reviewing any records relating to beneficial ownership, or interests in the Offered Veterans G.O. Bonds.

Principal, premium and interest payments on the Offered Veterans G.O. Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the State Treasurer, on payable dates in accordance with their respective holdings shown on DTC's records. Payments by Direct Participants and Indirect Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name" and will be the responsibility of such Direct or Indirect Participants and not of DTC (nor its nominee) or the State Treasurer, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest to Cede & Co. (or such other nominee and may be requested by an authorized representative of DTC) is the responsibility of the State Treasurer, disbursement of such payments to Direct Participants shall be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners shall be the responsibility of Direct and Indirect Participants.

The State Treasurer and the Underwriters cannot and do not give any assurances that DTC, Direct Participants, Indirect Participants or others will distribute payments with respect to the Offered Veterans G.O. Bonds received by DTC or its nominee as the registered owner, or any prepayment or other notices, to the Beneficial Owners, or that they will do so on a timely basis, or that DTC will serve and act in the manner described in this Official Statement.

If the State Treasurer determines not to continue the DTC book-entry only system, or DTC discontinues providing its services with respect to the Offered Veterans G.O. Bonds and the State Treasurer does not select another qualified security depository, the State shall deliver physical Offered Veterans G.O. Bond certificates to the Beneficial Owners. The Offered Veterans G. O. Bonds may thereafter be transferred upon the books of the State Treasurer by the registered owners, in person or by authorized attorney, upon surrender of Offered Veterans G.O. Bonds at the Office of the State Treasurer in Sacramento, California, accompanied by delivery of an executed instrument of transfer in a form approved by the State Treasurer and upon payment of any charges provided for in the Resolutions. Certificated Offered Veterans G.O. Bonds may be exchanged for Offered Veterans G.O. Bonds of other authorized denominations of the same aggregate principal amount and maturity at the Office of the State Treasurer in Sacramento, California, upon payment of any charges provided for in the Resolutions. No transfer or exchange of Offered Veterans G.O. Bonds shall be made by the State Treasurer during the period between the record date and the next Interest Payment Date.

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APPENDIX D

SUMMARY OF CONTINUING DISCLOSURE CERTIFICATES

STATE TREASURER'S DISCLOSURE CERTIFICATE

The State Treasurer, on behalf of the State, will execute at the time of delivery of the Offered Veterans G.O. Bonds to the Underwriters a Continuing Disclosure Certificate (the "Treasurer's Disclosure Certificate") for the Offered Veterans G.O. Bonds. The following is a summary of the provisions of the Treasurer's Disclosure Certificate. Such summary is qualified by reference to the complete Treasurer's Disclosure Certificate, which is available from the Office of the State Treasurer.

Definitions

Pursuant to the Treasurer's Disclosure Certificate, the following definitions will apply:

"**Annual Report**" shall mean the Annual Report filed by the State Treasurer pursuant to, and as described in, the Treasurer's Disclosure Certificate.

"**Beneficial Owner**" shall mean any person which has or shares the power, directly or indirectly, to make investment decisions concerning ownership of any applicable Offered Veterans G.O. Bonds (including persons holding applicable Offered Veterans G.O. Bonds through nominees, depositories or other intermediaries).

"**Dissemination Agent**" shall mean the State Treasurer, acting in its capacity as Dissemination Agent under the Treasurer's Disclosure Certificate, or any successor Dissemination Agent designated in writing by the State Treasurer.

"**Holder**" shall mean any person listed on the registration books of the State Treasurer as the registered owner of any applicable Offered Veterans G.O. Bonds.

"**Listed Events**" shall mean any of the events listed below under "Reporting of Significant Events."

"**National Repository**" shall mean any Nationally Recognized Municipal Securities Information Repository certified by the Securities and Exchange Commission to be the recipient of information of the nature of the Annual Reports required by the Treasurer's Disclosure Certificate.

"**Official Statement**" shall mean the Official Statement relating to the original issuance of the Offered Veterans G.O. Bonds, dated November 29, 2001.

"**Repository**" shall mean each National Repository and the State Repository.

"**Rule**" shall mean Rule 15c2-12(b)(5) adopted by the Securities and Exchange Commission under the Securities Exchange Act of 1934, as the same may be amended from time to time.

"**State**" shall mean the State of California.

"**State Repository**" shall mean any public or private repository or entity within the State created for the purpose of receiving information of the nature of the Annual Reports or reports of material events required by the Treasurer's Disclosure Certificate and recognized as such by the Securities and Exchange Commission. As of the date of this Official Statement, there is no State Repository.

Annual Reports

The State Treasurer on behalf of the State shall, not later than April 1 of each year in which the applicable Offered Veterans G.O. Bonds are outstanding, commencing with the report for the next Fiscal Year, provide an Annual Report consistent with the requirements of the Treasurer's Disclosure Certificate (an "Annual Report") to each Repository; provided that the audited financial statements of the State may be submitted separately from the balance of the Annual Report and later than the date required above for the filing of the Annual Report if they are not available by that date. The State Treasurer shall make a copy of any Annual Report available to any person who requests a copy at a cost not exceeding the reasonable cost of duplication and delivery.

If in any year, the State Treasurer does not provide the Annual Report to each Repository by the time specified above, the State Treasurer shall instead file a notice with each Repository stating that the Annual Report has not been timely completed and, if known, stating the date by which the State Treasurer expects to file the Annual Report.

The Annual Report shall contain or include by reference the following:

(1) The audited General Purpose Financial Statements of the State for the fiscal year ended on the previous June 30, prepared in accordance with generally accepted accounting principles promulgated to apply to government entities from time to time by the Governmental Accounting Standards Board. If the State's audited financial statements are not available by the time the Annual Report is required to be filed pursuant to the Treasurer's Disclosure Certificate, the Annual Report shall contain unaudited financial statements in a format similar to the financial statements contained in the applicable final Official Statement, and the audited financial statements shall be filed in the same manner as the Annual Report when they become available.

(2) Financial information relating to the State's General Fund budget for the fiscal year ended on the previous June 30 and information concerning the State budget for the fiscal year in which the Annual Report is issued. Such information shall describe the sources of revenues, the principal categories of expenditures, and changes in fund balances, a summary of expected State revenues and budgeted expenditures, and significant assumptions relating to revenue and expenditure expectations; including updating the following tables which appear under the caption APPENDIX A - "THE STATE OF CALIFORNIA - Current State Budget" in the Official Statement:

Table Entitled

Statement of Revenues, Expenditures, and Changes in Fund Balance –
General Fund
Revenue and Expenditure Assumptions

(3) Information concerning the total amount of the State's authorized and outstanding debt, long-term lease obligations and other long-term liabilities as of the end of the most recent June 30, which debt is supported by payments from the State's General Fund and which includes short-term debt. Such information shall include schedules of debt service for outstanding general obligation bonds and lease-purchase debt. This shall be accomplished by updating the following tables which appear under the caption APPENDIX A – "THE STATE OF CALIFORNIA – State Debt Tables" in the Official Statement.

Table Entitled

Authorized and Outstanding General Obligation Bonds

Outstanding State Debt

Schedule of Debt Service Requirements for General Fund
General Obligation Bonds

Schedule of Debt Service Requirements for
Enterprise Fund General Obligation Bonds

Schedule of Debt Service Requirements for
Lease-Purchase Debt

State Public Works Board and
Other Lease-Purchase Financing Outstanding Issues

State Agency Revenue Bonds and
Conduit Financing

The Annual Report may consist of one or more documents. Any or all of the items listed above may be included in the Annual Report by reference to other documents which have been filed by the State with each of the Repositories, including any final official statement (in which case such final official statement must also be available from the Municipal Securities Rulemaking Board). The State Treasurer shall clearly identify in the Annual Report each such document so included by reference.

Reporting of Significant Events

The State Treasurer, on behalf of the State shall give, or cause to be given, prompt notice of the occurrence of any of the following events with respect to the Offered Veterans G.O. Bonds (hereafter referred to as a "Listed Event"), if material:

1. principal and interest payment delinquencies;
2. non-payment related defaults;
3. modifications to rights of Bondholders;
4. optional, contingent or unscheduled bond calls;

5. defeasances;
6. rating changes;
7. adverse tax opinions or events adversely affecting the tax-exempt status of the applicable Offered Veterans G.O. Bonds;
8. unscheduled draws on debt service reserves reflecting financial difficulties;
9. unscheduled draws on credit enhancements reflecting financial difficulties;
10. substitution of credit or liquidity providers, or their failure to perform; or
11. release, substitution or sale of property securing repayment of the applicable Offered Veterans G.O. Bonds.

The State Treasurer shall timely file a notice of each such occurrence, if it is material under applicable federal securities laws, with the Municipal Securities Rulemaking Board and each Repository. The State notes that items 8, 9, 10 and 11 above are not applicable to the Offered Veterans G.O. Bonds.

Other Provisions

Termination of Reporting Obligation. The State's obligations under the Treasurer's Disclosure Certificate shall terminate upon the maturity, legal defeasance, prior redemption or acceleration of all of the applicable outstanding Offered Veterans G.O. Bonds.

Dissemination Agent. The State Treasurer may, from time to time, appoint or engage a Dissemination Agent to assist it in carrying out the obligations under the Treasurer's Disclosure Certificate, and may discharge any such Dissemination Agent, with or without appointing a successor Dissemination Agent. If at any time there is not any other designated Dissemination Agent, the State Treasurer shall be the Dissemination Agent. The initial Dissemination Agent shall be the State Treasurer.

Amendment; Waiver. Notwithstanding any other provision of the Treasurer's Disclosure Certificate, the State Treasurer may amend or waive any provision of the Treasurer's Disclosure Certificate, provided that the following conditions are satisfied:

(a) If the amendment or waiver relates to the provisions of the Treasurer's Disclosure Certificate dealing with the timing or content of the Annual Report or the giving of notice of Listed Events, it may only be made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature or status of an obligated person with respect to the applicable Offered Veterans G.O. Bonds, or the type of business conducted;

(b) The undertaking, as amended or taking into account such waiver, would, in the opinion of nationally recognized bond counsel, have complied with the requirements of the Rule at the time of the original issuance of the applicable Offered Veterans G.O. Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

(c) The amendment or waiver either (i) is approved by the Holders of sixty percent (60%) of the applicable Offered Veterans G.O. Bonds, or (ii) does not, in the opinion of nationally recognized bond counsel, materially impair the interests of the Holders or Beneficial Owners of the applicable Offered Veterans G.O. Bonds.

Additional Information. Nothing in the Treasurer's Disclosure Certificate shall be deemed to prevent the State Treasurer from disseminating any other information, using the means of dissemination set forth in the Treasurer's Disclosure Certificate or any other means of communication, or including any other information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is required by the Treasurer's Disclosure Certificate. If the State Treasurer chooses to include any information in any Annual Report or notice of occurrence of a Listed Event in addition to that which is specifically required by the Treasurer's Disclosure Certificate, the State Treasurer shall not have any obligation to update such information or include it in any future Annual Report or notice of occurrence of a Listed Event.

Beneficiaries. The Treasurer's Disclosure Certificate shall inure solely to the benefit of the Holders and Beneficial Owners from time to time of the Offered Veterans G.O. Bonds, and shall create no rights in any other person or entity (except the right of the State Treasurer or any Bondholder or Beneficial Owner to enforce the provisions of the Treasurer's Disclosure Certificate on behalf of the Bondholders). The Treasurer's Disclosure Certificate is not intended to create any monetary rights on behalf of any person based upon the Rule. The sole remedy in the event of any failure of the State Treasurer to comply with the Treasurer's Disclosure Certificate shall be an action to compel performance of any act required thereunder.

DEPARTMENT'S DISCLOSURE CERTIFICATE

The Secretary of Veterans Affairs (the "Secretary"), on behalf of the Department, will execute a Continuing Disclosure Certificate (the "Department's Disclosure Certificate") for the Offered Veterans G.O. Bonds. The following is a summary of the Department's Disclosure Certificate. Such summary is qualified by reference to the complete Department's Disclosure Certificate, which is available from the Department.

Certain Definitions

Defined terms used in the Department's Disclosure Certificate and not otherwise defined therein have the meanings set forth elsewhere in this Official Statement.

"**Beneficial Owner**" means a Beneficial Owner of Subject Bonds, as determined pursuant to the Rule.

"**Bonds**" means, at any time, all of the State's then Outstanding Offered Veterans G.O. Bonds, collectively.

"**Fiscal Year**" means that period established by the Department with respect to which its, as applicable, Audited Financial Statements or Unaudited Financial Statements are prepared. As of the date of the Department's Disclosure Certificate, the Department's Fiscal Year begins on July 1 and ends on June 30 of the next calendar year.

"**Holders**" means the registered owners of the Subject Bonds.

"**MSRB**" means the Municipal Securities Rulemaking Board established pursuant to Section 15B(b)(1) of the Securities Exchange Act of 1934, as amended.

"**Notice**" means written notice, sent for overnight delivery via the United States Postal Service or a private delivery service which provides evidence of delivery.

"**Notice Address**" means with respect to the Department:

State of California Department of Veterans Affairs
1227 O Street
Sacramento, CA 95814
Attention: Bond Finance Division

"**NRMSIR**" means, at any time, a then-existing nationally recognized municipal securities information repository, as recognized from time to time by the SEC for the purposes referred to in the Rule.

"**Official Statement**" means the Official Statement relating to the original issuance of the Offered Veterans G.O. Bonds.

"**Rule**" means the applicable provisions of Rule 15c2-12 promulgated by the SEC under the Securities Exchange Act of 1934, as amended (17 CFR Part 240, § 240.15c2-12), as in effect on the date of the Department's Disclosure Certificate, including any official interpretations thereof.

"**SEC**" means the United States Securities and Exchange Commission.

"**Securities Counsel**" means legal counsel expert in federal securities laws.

"**SID**" means, at any time, a then-existing state information depository, if any, as operated or designated as such by or on behalf of the State and recognized by the SEC for the purposes referred to in the Rule.*

"**Subject Bonds**" means those Offered Veterans G.O. Bonds and those Veterans G.O. Bonds subject to the same Department's Disclosure Certificate.

Provision of Annual Financial Information

The Department will, not later than the first day of the tenth calendar month after the end of each of the Department's Fiscal Years, commencing with the report for the 2000-2001 Fiscal Year, provide to the State Treasurer and to each NRMSIR and the SID the Annual Financial Information (as described hereinbelow). The audited financial statements of the Department may be submitted separately from the balance of the Annual Financial Information, and later than the date required for the filing of the Annual Financial Information if not available by that date.

The Department's Disclosure Certificate requires the Department to provide, in a timely manner, notice of any failure by it to provide Annual Financial Information to each NRMSIR and the SID on or before the date described in the first paragraph under this heading, to the SID, to the State Treasurer, and to either (i) each NRMSIR or (ii) the MSRB.

Content of Annual Financial Information

The Department's Annual Financial Information shall contain or include by reference the following:

(a) financial information or operating data of the types included in EXHIBIT 2 to APPENDIX B of the Official Statement entitled "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA"; and

(b) the audited financial statements of the 1943 Fund for the Fiscal Year ended on the previous June 30, prepared in accordance with generally accepted accounting principles established by the Financial Accounting Standards Board, if available, or unaudited financial statements for such Fiscal Year.

If not provided as part of the Annual Financial Information by the date required (as described above under "Provision of Annual Financial Information"), the Department shall provide audited financial statements, when and if available, to the State Treasurer and to each NRMSIR and the SID.

Any or all of the items listed above may be included by specific reference to other documents, including official statements of debt issues of the Department or related public

* As of the date of this Official Statement, there is no SID.

entities, which have been submitted to each NRMSIR and the SID or the SEC. (If such document is an official statement, it must also be available from the MSRB.) Annual Financial Information may be provided in one document or multiple documents, and at one time or in part from time to time.

Additional Information

Nothing in the Department's Disclosure Certificate will be deemed to prevent the Department from disseminating any other information, using the means of dissemination set forth in such Department's Disclosure Certificate or any other means of communication, or including any other information in any Annual Financial Information, in addition to that which is required by the Department's Disclosure Certificate. If the Department chooses to include any information in any Annual Financial Information in addition to that which is specifically required by the Department's Disclosure Certificate, the Department will have no obligation under the Department's Disclosure Certificate to update such information or include it in any future Annual Financial Information.

Amendment of Department's Disclosure Certificate

The Department's Disclosure Certificate may be amended and any provision of the Department's Disclosure Certificates be waived, without the consent of the Holders or Beneficial Owners, except as described in clause 4 (ii) below, under the following conditions: (1) such amendment or waiver is made in connection with a change in circumstances that arises from a change in legal (including regulatory) requirements, a change in law (including rules or regulations) or in interpretations thereof, or a change in the identity, nature or status of the Department or the type of business conducted thereby, (2) the Department's Disclosure Certificate as so amended or waived would have complied with the requirements of the Rule as of the date of each primary offering of Subject Bonds affected by such amendment or waiver, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances, (3) the Department shall have obtained an opinion of Securities Counsel, addressed to the Department and the State Treasurer, to the same effect as set forth in clause (2) above, (4) either (i) a party unaffiliated with the Department (such as bond counsel), acceptable to the Department, has determined that the amendment or waiver does not materially impair the interests of the Beneficial Owners, or (ii) the applicable Holders consent to the amendment to or waiver of such Department's Disclosure Certificate, and (5) the Department shall have delivered copies of such amendment or waiver to the SID, to the State Treasurer, and to either each NRMSIR or the MSRB.

In addition to the foregoing, the Department may amend the Department's Disclosure Certificate, and any provision of the Department's Disclosure Certificate may be waived, if the Department shall have received an opinion of Securities Counsel, addressed to the Department and the State Treasurer, to the effect that the adoption and the terms of the amendment or waiver would not, in and of themselves, cause the undertakings in such Department's Disclosure Certificate to violate the Rule, taking into account any subsequent change in or official interpretation of the Rule.

Benefit; Enforcement

The provisions of the Department's Disclosure Certificate will inure solely to the benefit of the Holders and Beneficial Owners from time to time.

Except as described in this paragraph, the provisions of the Department's Disclosure Certificate will create no rights in any other person or entity. The obligation of the Department to comply with the provisions of the Department's Disclosure Certificate is enforceable (i) in the case of enforcement of obligations to provide financial statements, financial information, operating data, and notices, by any Beneficial Owner of outstanding Subject Bonds, or (ii) in the case of challenges to the adequacy of the financial statements, financial information, and operating data so provided, by the Holders of not less than twenty-five percent (25%) in aggregate principal amount of the Subject Bonds at the time Outstanding.

The right to enforce the provisions of the Department's Disclosure Certificate is limited to a right, by action in mandamus or for specific performance, to compel performance of the Department's obligations under the Department's Disclosure Certificate. Any failure by the Department to perform in accordance with the Department's Disclosure Certificate will not constitute a default under the Subject Bonds, and the rights and remedies provided by the Subject Bonds upon the occurrence of a default will not apply to any such failure.

Termination of Reporting Obligation

The Department's obligations under the Department's Disclosure Certificate with respect to the Subject Bonds terminate upon the legal defeasance, prior redemption, or payment in full of all of such Subject Bonds. The Department shall give notice of any such termination to the SID and to either each NRMSIR or the MSRB.

The Department's Disclosure Certificate, or any provision thereof, will be null and void to the extent set forth in the opinion of Securities Counsel obtained by the Department and addressed to the Department and the State Treasurer, to the effect that those portions of the Rule which require the provisions of such Department's Disclosure Certificate, or any of such provisions, do not or no longer apply to the applicable Subject Bonds, whether because such portions of the Rule are invalid, have been repealed, or otherwise, as will be specified in such opinion, and the Department delivers notice to such effect to the State Treasurer, to the SID and to either each NRMSIR or the MSRB.

Governing Law

The Department's Disclosure Certificate will be construed and interpreted in accordance with the laws of the State, and any suits and actions arising out of the Department's Disclosure Certificate will be instituted in a court of competent jurisdiction in the State, *provided that,* to the extent such Department's Disclosure Certificate addresses matters of federal securities laws, including the Rule, the Department's Disclosure Certificate will be construed in accordance with such federal securities laws and official interpretations thereof.

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APPENDIX E

CERTAIN FEDERAL TAX CODE REQUIREMENTS

The Federal Tax Code restricts the issuance of Federally tax-exempt bonds to finance mortgage loans for single family housing or to refund such bonds.

Those Federal Tax Code restrictions are not the same for all such tax-exempt bonds. There are three types of such tax-exempt bonds: (i) qualified mortgage bonds, which provide Qualified Mortgage Bond Proceeds, (ii) qualified veterans' mortgage bonds, which provide Qualified Veterans' Mortgage Bond Proceeds, and (iii) pre-Ullman bonds, which provide Unrestricted Moneys. Revenue Bonds may be either qualified mortgage bonds or pre-Ullman Bonds. ("Pre-Ullman bonds" are bonds issued before 1981, or bonds issued to refund such bonds.) Veterans G.O. Bonds may be either qualified veterans' mortgage bonds or pre-Ullman bonds. The principal Federal Tax Code restrictions relate to: (i) the use of proceeds of the bond issue, (ii) the yield on the financed mortgage loans and from certain non-mortgage investments related to the issue, (iii) for qualified mortgage bonds and qualified veterans' mortgage bonds, loan eligibility requirements, (iv) for qualified mortgage bonds, the availability of proceeds of the issue for financing housing located in "targeted areas," and (v) certain matters relating to the issue itself.

See "TAX MATTERS" for information regarding the requirements applicable to the Offered Veterans G.O. Bonds.

Failure to comply with the applicable provisions of the Federal Tax Code may result in interest on the applicable issue of bonds being included in gross income for federal income tax purposes retroactive to the date of issuance thereof.

Loan Eligibility Requirements Imposed by the Federal Tax Code on Qualified Mortgage Bond Proceeds and Qualified Veterans' Mortgage Bond Proceeds

Qualified Mortgage Bond Proceeds

The Federal Tax Code contains the following loan eligibility requirements with respect to Qualified Mortgage Bond Proceeds, except that the requirements described under "First-Time Homebuyer Requirement," "Purchase Price Limitation," and "Other Requirements Imposed by the Code – Recapture Provision" do not apply to home improvement loans, and the requirements described under "Qualified Home Improvement Loans" do not apply to loans for the acquisition of single family homes. None of those requirements applies to pre-Ullman bonds or qualified veterans' mortgage bonds.

Residence Requirement. The Federal Tax Code requires that each of the premises financed with the lendable proceeds of qualified mortgage bonds be a one-to-four-family residence, one unit of which can reasonably be expected to become the principal residence of the veteran within a reasonable time after the financing is provided. Certain documents adopted by the Department establish procedures to be followed in connection with Contracts of Purchase which finance the acquisition of single family homes in order to assure that interest paid on the qualified mortgage bonds not be included in gross income for Federal income tax purposes under the Federal Tax Code (the "Single Family Program Documents"). Certain documents adopted by the Department establish procedures to be followed in connection with Contracts of Purchase to finance home improvement loans intended to assure that interest paid on the qualified mortgage bonds is not included in gross income for Federal income tax purposes under the Federal Tax Code (the "Home Improvement Program Documents," together with the Single Family Program Documents, the "Program Documents"). In connection with the financing of a Contract of Purchase, the Program Documents require that each veteran submit an affidavit stating such person's intention to occupy the premises as his principal residence within 60 days after closing of the Contract of Purchase.

First-Time Homebuyer Requirement. The Federal Tax Code requires that, subject to certain exceptions, the lendable proceeds of qualified mortgage bonds be used to provide financing to borrowers who have not had a present ownership interest in their principal residence during the three-year period prior to execution of the mortgage loan. All financing with respect to targeted area residences and residences on land possessed under certain contract for deed agreements is treated as satisfying the first time homebuyer requirement. Veterans subject to this requirement are required to provide federal income tax returns for the previous three years or other appropriate certifications to allow verification that no deductions or other entries have been made that would indicate any such ownership interest.

New Mortgage Requirement. The Federal Tax Code requires that, with certain limited exceptions, the lendable proceeds of qualified mortgage bonds finance new mortgage loans only and that no proceeds may be used to acquire or replace an existing mortgage loan, which would include the refinancing of a pre-existing mortgage loan. The Program Documents state that the Department will verify compliance with the new mortgage requirement by requiring each veteran to certify prior to financing, subject to such exceptions, that no refinancing of a prior mortgage loan is being effected.

Purchase Price Limitation. The Federal Tax Code requires that the purchase price of the residence financed with the lendable proceeds of qualified mortgage bonds may not exceed 90% of the average area purchase price applicable to such residence or 110% of the applicable average area purchase price in the case of residences located in targeted areas. The Program Documents state that the Department will verify compliance with the purchase price limitations by requiring each veteran and seller of a residence to make certifications regarding the purchase price of such residence.

Income Limitation. The Federal Tax Code requires that all mortgage loans made from the lendable proceeds of qualified mortgage bonds be made only to borrowers whose family income does not exceed 115% (for mortgage loans made to families with fewer than three members, 100%) of the applicable median family income. An exception is provided for mortgage loans financed with the lendable proceeds of qualified mortgage bonds made with respect to targeted area residences that permits two-thirds in aggregate amount of such mortgage loans to be made with respect to borrowers whose family income does not exceed 140% (for mortgage loans made to families with fewer than three members, 120%) of the applicable median family income and one-third in aggregate amount of such loans to be made without regard to any income limitation.

Federal tax law permits higher income limits for persons financing homes located in certain "high housing cost areas." A high housing cost area is a statistical area for which the ratios of the area's average purchase price for existing and new single family houses to the area's median income exceed 120% of the same ratios determined on a national basis. These ratios are determined separately with respect to new and existing single family residences. An area is a high housing cost area only if the ratios for both new and existing houses meet the 120% test. In high housing cost areas, the veteran income limits are increased above 115% (or 100%, as applicable) by one percent for each percentage point (1%) by which the new or existing housing price ratio, whichever is smaller, exceeds 120%. However, the new limit cannot exceed 140% (or 120%, as applicable) of the income limits otherwise applicable. Certain areas of the State may qualify as high housing cost areas.

Family income includes income of all individuals executing both the note and mortgage and occupying the dwelling as their principal residence.

Requirements as to Assumptions. The Federal Tax Code provides that a mortgage loan may be assumed only if each of the then applicable residence requirements, first-time-homebuyer requirement, purchase price limitation, and income limitation is met with respect to such assumption. The Contracts of Purchase contain a "due on sale" clause, and the Program Documents state that the assumption of a Contract of Purchase should not be permitted unless these requirements have been met and the appropriate certifications have been obtained.

Qualified Home Improvement Loans. The Federal Tax Code requires that a home improvement loan financed with the lendable proceeds of qualified mortgage bonds not exceed $15,000, be made only with respect to an owner-occupied residence, and finance alterations, repairs, and improvements on or in connection with an existing one-to-four-family residence by the owner thereof, but only if such alterations, repairs and improvements substantially protect or improve the basic livability or energy efficiency of the property.

General. Qualified mortgage bonds treated under the Federal Tax Code as one bond issue for federal tax purposes ("qualified mortgage issue") are deemed to meet the loan eligibility requirements of the Federal Tax Code if (i) the issuer in good faith attempted to meet all the loan eligibility requirements before the mortgage loans were executed, (ii) any failure to comply with the loan eligibility requirements is corrected within a reasonable period after such failure is first discovered, and (iii) 95% or more of the proceeds of the issue used to make mortgage loans was used to finance residences that met all such requirements at the time the mortgage loans were executed. In determining whether 95% or more of the proceeds has been so used, the Federal Tax Code permits the Department to rely on an affidavit of the veteran and of the seller as to the purchase price of a residence and an affidavit of the veteran and an examination of copies of the veteran's Federal income tax returns for the last three years preceding the date the Contract of Purchase is or was executed even though the relevant information in such affidavits and income tax returns should ultimately prove to be untrue, unless the Department knows or has reason to believe that such information is false.

Qualified Veterans' Mortgage Bond Proceeds

The Federal Tax Code requires that each mortgagor to whom financing is provided under a qualified veterans' mortgage bond issue have served on active duty at some time before January 1, 1977 and apply for financing before the later of January 31, 1985 or the date which is 30 years after the last date on which the veteran left active service. The Department has established and has covenanted to comply with such requirements.

Generally, only the loan eligibility requirements stated above under "Qualified Mortgage Bond Proceeds - Residence Requirement," "- New Mortgage Requirement" and "- Qualified Home Improvement Loans" (*except* the $15,000 maximum loan amount) apply to Qualified Veterans' Mortgage Bond Proceeds.

Other Requirements Imposed by the Federal Tax Code

General. The Federal Tax Code provides that gross income for federal income tax purposes does not include interest on a mortgage revenue bond if it is a qualified mortgage bond or a qualified veterans' mortgage bond. A qualified mortgage bond is a part of an issue of a state or political subdivision all the proceeds of which (net of amounts applied to any costs of issuance thereof and to fund a reasonably required reserve) are used to finance (or to refund bonds all of such net proceeds of which were used to finance) owner-occupied residences and that meets certain (i) general requirements, (ii) arbitrage restrictions on the use and investment of proceeds of the issue, and (iii) loan eligibility requirements set forth in the Federal Tax Code and as more fully described above under "Loan Eligibility Requirements Imposed by the Federal Tax Code." A qualified veterans' mortgage bond is part of an issue 95 percent or more of the net proceeds of which are used to provide residences to veterans and that meets certain (i) general requirements, (ii) arbitrage restrictions on the use and investment of proceeds of the issue, and (iii) loan eligibility requirements set forth in the Federal Tax Code and as more fully described above under "Loan Eligibility Requirements Imposed by the Federal Tax Code."

Volume Limitation, Targeted Area and Required Reports. The first general requirement of the Federal Tax Code, applicable to qualified mortgage bonds, is that the aggregate amount of private activity bonds (exclusive of qualified veterans' mortgage bonds) that may be issued by the Department in any calendar year (or previous years' carried forward amount) must not exceed the portion of the private activity bond volume limit for the State for such calendar year that is allocated by the State to the Department. With respect to qualified veterans' mortgage bonds, a separate limit is based on statutory formulae. The second general requirement of the Federal Tax Code applicable to qualified mortgage bonds is that at least 20% of the lendable proceeds of an issue of bonds which are not refunding bonds (if such set-aside was satisfied with respect to the bonds being refunded) must be made available (and applied with reasonable diligence) for owner-financing of residences in targeted areas (as defined by the Federal Tax Code) for at least one year after the date on which such funds are first available for such owner-financing (the "targeted area requirement"). The third general requirement of the Federal Tax Code requires the issuer of qualified mortgage bonds and qualified veterans' mortgage bonds to file with the Internal Revenue Service reports on the issuance of its qualified mortgage bonds or qualified veterans mortgage bonds following such issuance, as well as an annual qualified mortgage loan information report.

Yield Limitations and Rebate. The Federal Tax Code requires that the effective interest rate on mortgage loans financed with the lendable proceeds of qualified mortgage bonds and qualified veterans' mortgage bonds may not exceed the yield on the issue by more than 1.125% (1.50% for pre-Ullman bonds), and that certain investment earnings on non-mortgage investments, calculated based upon the extent such investment earnings exceed the amount that would have been earned on such investments if the investments were invested at a yield equal to the yield on the issue, be rebated to the United States or to veterans. These requirements apply to both Revenue Bonds and Veterans G.O. Bonds, except that for Veterans G.O. Bonds, rebate, absent an election to pay to the United States, is to veterans. The Department has established procedures to determine the amount of excess earnings, if any, that must be rebated to the United States or to veterans. See APPENDIX B - "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND" and "-THE PROGRAM - Contracts of Purchase" for discussions of provisions of the Veterans Code which affect the Department's ability to establish and to change interest rates on Contracts of Purchase.

Recapture Provision Applicable to Qualified Mortgage Bonds. For certain mortgage loans made after December 31, 1990 from the lendable proceeds of qualified mortgage bonds issued after August 15, 1986 (not including the Offered Veterans G.O. Bonds), and for assumptions of such mortgage loans, the Federal Tax Code requires a payment to the United States from certain borrowers upon sale or other disposition of their homes (the "Recapture Provision"). The Recapture Provision requires that an amount determined to be the subsidy provided by a qualified mortgage bond financing to a borrower be paid to the United States on disposition of the residence (but not in excess of 50% of the gain realized by the borrower). The recapture amount would (i) increase over the period of ownership, with full recapture occurring if the residence were sold between four and five full years after the closing of the mortgage loan and (ii) decline ratably to zero with respect to sales occurring between five and nine full years after the closing of the mortgage loan. An exception excludes from recapture part or all of the subsidy in the case of certain assisted individuals whose incomes are less than prescribed amounts at the time of the disposition. The Federal Tax Code requires an issuer to inform borrowers of certain information with respect to the Recapture Provision. The Program Documents include a form of notice and establish procedures to send such notice.

Required Redemptions. For qualified mortgage bonds issued after 1988, the Federal Tax Code permits repayments (including prepayments) of principal of mortgage loans financed with the proceeds of an issue of such bonds to be used to make additional mortgage loans for only 10 years from the date of issuance of the bonds (or the date of issuance of the original bonds in the case of refundings), after which date such amounts must be used to redeem bonds, except for a $250,000 *de minimis* amount. As a result, the Department is required by the Federal Tax Code to redeem Revenue Bonds which are qualified mortgage bonds from repayments (including prepayments) of principal of certain Contracts of Purchase not later than the close of the semi-annual period after the payment is received.

Compliance. The Federal Tax Code states that an issuer will be treated as meeting the targeted area requirement, the arbitrage restrictions on mortgage loans, and the recapture information requirements if it in good faith attempted to meet all such requirements and any failure to meet such requirements was due to inadvertent error after taking all reasonable steps to comply with such requirements.

APPENDIX F

LEGAL OPINION OF ATTORNEY GENERAL

Bill Lockyer
Attorney General
STATE OF CALIFORNIA
1300 I Street, Suite 1101
Sacramento, California 95814

(Closing Date)

Office of the Treasurer of the State
of California
915 Capitol Mall, Room 235
Sacramento, California 95814

Ladies and Gentlemen:

The undersigned, Attorney General of the State of California (the "State"), has examined upon request copies of proceedings taken by the State in connection with the issuance of the State's $3,400,000 aggregate principal amount Veterans General Obligation Bonds, Series BY (the "Series BY Bonds") and $107,925,000 aggregate principal amount Veterans General Obligation Bonds, Series BZ (the "Series BZ Bonds," and together with the Series BY Bonds, the "Series BY and BZ Bonds") and the sale of the Series BY and BZ Bonds to the initial purchasers thereof. The Series BY and BZ Bonds are issued pursuant to (i) the Veterans Bond Acts identified in Schedule A hereto (collectively the "Law"), which is incorporated by reference, each of which was approved by the electors of the State, (ii) Part 3 of Division 4 of Title 2 of the California Government Code, and (iii) resolutions (the "Resolutions") adopted by the Veterans Finance Committee of 1943 on February 16, 2000, identified in Schedule B hereto, which is incorporated by reference.

The Series BY and BZ Bonds are dated, mature on the dates in the principal amounts, bear interest, if any, and are payable as provided in the Resolutions. The Series BY and BZ Bonds are subject to redemption prior to maturity in whole or in part as provided in the Resolutions.

In connection with the issuance of the Series BY and BZ Bonds, the undersigned has examined (a) a copy of the Resolutions, and (b) such other opinions, documents, certificates and letters as we deem relevant and necessary in rendering this opinion.

From such examination, the undersigned is of the opinion that the State has lawful authority for the issuance of the Series BY and BZ Bonds, and the Series BY and BZ Bonds constitute the valid and legally binding general obligations of the State payable in accordance with the Law from the General Fund of the State. The full faith and credit of the State of California are pledged for the punctual payment of the principal of and interest on the Series BY and BZ Bonds.

In rendering this opinion, we advise you that the enforceability of the Series BY and BZ Bonds and the Resolutions may be limited by bankruptcy, insolvency, reorganization, moratorium, arrangement, fraudulent conveyance and other laws relating to or affecting creditors' rights or remedies, to the application of equitable principles (regardless of whether such enforceability is considered in a proceeding in equity or at law), to the exercise of judicial discretion in appropriate cases and to limitations on legal remedies against the State of California and its subdivisions and departments.

Very truly yours,

BILL LOCKYER,
ATTORNEY GENERAL

By: ______________________________
Deputy Attorney General

Schedule A

1. $3,400,000 principal amount of Veterans General Obligation Bonds, Series BY, authorized under the Veterans Bond Act of 1988.

2. $23,690,000 principal amount of Veterans General Obligation Bonds, Series BZ1, authorized under the Veterans Bond Act of 1986.

3. $42,425,000 principal amount of Veterans General Obligation Bonds, Series BZ2, authorized under the Veterans Bond Act of 1988.

4. $41,810,000 principal amount of Veterans General Obligation Bonds, Series BZ3, authorized under the Veterans Bond Act of 1990.

Schedule B

Bond Act	Resolution Number	Date of Adoption by Veterans Finance Committee Resolution
Veterans Bond Act of 1986	XVI	February 16, 2000
Veterans Bond Act of 1988	IX	February 16, 2000
Veterans Bond Act of 1990	IX	February 16, 2000

APPENDIX G

LEGAL OPINION OF BOND COUNSEL

Hawkins, Delafield & Wood
633 West Fifth Street
Los Angeles, California 90071

(Closing Date)

Office of the Treasurer of the State
of California
915 Capitol Mall, Room 235
Sacramento, California 95814

Ladies and Gentlemen:

We have acted as bond counsel to the State of California (the "State"), and in such capacity we have examined upon request copies of proceedings taken by the State in connection with the issuance of the State's $3,400,000 aggregate principal amount Veterans General Obligation Bonds, Series BY (the "Series BY Bonds") and $107,925,000 aggregate principal amount Veterans General Obligation Bonds, Series BZ (the "Series BZ Bonds," and together with the Series BY Bonds, the "Series BY and BZ Bonds") and the sale of the Series BY and BZ Bonds to the initial purchasers thereof. The Series BY and BZ Bonds are issued pursuant to (i) the Veterans Bond Acts identified in Schedule A hereto (collectively the "Law"), which is incorporated by reference, each of which was approved by the electors of the State, (ii) Part 3 of Division 4 of Title 2 of the California Government Code, and (iii) resolutions (the "Resolutions") adopted by the Veterans Finance Committee of 1943 on February 16, 2000, identified in Schedule B hereto, which is incorporated by reference.

The Series BY and BZ Bonds are dated, mature on the dates in the principal amounts, bear interest, if any, and are payable as provided in the Resolutions. The Series BY and BZ Bonds are subject to redemption prior to maturity in whole or in part as provided in the Resolutions.

The Department of Veterans Affairs of the State of California (the "Department") intends to issue its Home Purchase Revenue Bonds, 2002 Series A (the "2002 Revenue Bonds") in March 2002. The Series BY and BZ Bonds and the 2002 Revenue Bonds are treated as a single issue for certain federal tax purposes under the Internal Revenue Code of 1986, as amended (the "Code"). Applicable federal tax law establishes certain requirements that must be met subsequent to the issuance of the Series BY and BZ Bonds and the 2002 Revenue Bonds in order that interest on the Series BY and BZ Bonds not be included in gross income for Federal income tax purposes under the Code. The Department has adopted documents with respect to its program (the "Program Documents") that establish procedures under which, if followed, such requirements can be met. The State and the Department have covenanted in the Resolutions and in tax certificates and other documents applicable to the issuance of the Series BY and BZ Bonds and the 2002

Revenue Bonds (collectively with the Program Documents, the "Documents"), to all times perform all acts and things permitted by law and necessary and desirable in order to assure that interest paid on the Series BY and BZ Bonds shall not be included in gross income for federal income tax purposes under the Code. In rendering this opinion, we have relied upon such covenants and have assumed compliance by the State and the Department with the provisions of such Documents.

In connection with the issuance of the Series BY and BZ Bonds, we have examined (a) a copy of the Resolutions, and (b) such other opinions, documents, certificates and letters as we deem relevant and necessary in rendering this opinion.

From such examination, we are of the opinion that:

i) The State has lawful authority for the issuance of the Series BY and BZ Bonds, and the Series BY and BZ Bonds constitute the valid and legally binding general obligations of the State payable in accordance with the Law from the General Fund of the State. The full faith and credit of the State of California are pledged for the punctual payment of the principal of and interest on the Series BY and BZ Bonds.

ii) Under existing statutes and court decisions and assuming compliance with certain tax covenants described herein, interest on the Series BY and BZ Bonds is not included in gross income for Federal income tax purposes pursuant to Section 103 of the Code, and interest on the Series BY Bonds is not treated as a preference item for purposes of calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, however, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations. Interest on the Series BZ Bonds is treated as a preference item for purposes of calculating the alternative minimum tax imposed on individuals and corporations under the Code.

iii) Interest on the Series BY and BZ Bonds is exempt from State personal income taxation under present State law.

In rendering this opinion, we express no opinion regarding any other Federal or state tax consequences with respect to the Series BY and BZ Bonds. We render this opinion under existing statutes and court decisions as of the issue date, and assume no obligation to update this opinion after the issue date to reflect any future action, fact or circumstance, or change in law or interpretation, or otherwise. In rendering this opinion, we express no opinion on the effect of any action taken after the date of the opinion or not taken in reliance upon an opinion of other counsel on the exclusion from gross income for Federal income tax purposes of interest on the Series BY and BZ Bonds, or under state and local tax law.

In rendering this opinion, we are advising you that the enforceability of the Series BY and BZ Bonds may be limited by bankruptcy, moratorium, insolvency, or other laws affecting creditors' rights or remedies and is subject to general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law).

Very truly yours,

Schedule A

1. $3,400,000 principal amount of Veterans General Obligation Bonds, Series BY, authorized under the Veterans Bond Act of 1988.

2. $23,690,000 principal amount of Veterans General Obligation Bonds, Series BZ1, authorized under the Veterans Bond Act of 1986.

3. $42,425,000 principal amount of Veterans General Obligation Bonds, Series BZ2, authorized under the Veterans Bond Act of 1988.

4. $41,810,000 principal amount of Veterans General Obligation Bonds, Series BZ3, authorized under the Veterans Bond Act of 1990.

Schedule B

Bond Act	Resolution Number	Date of Adoption by Veterans Finance Committee Resolution
Veterans Bond Act of 1986	XVI	February 16, 2000
Veterans Bond Act of 1988	IX	February 16, 2000
Veterans Bond Act of 1990	IX	February 16, 2000

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APPENDIX H

FORM OF OFFERED VETERANS G.O. BONDS MUNICIPAL BOND INSURANCE POLICY OF MBIA INSURANCE CORPORATION

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FINANCIAL GUARANTY INSURANCE POLICY

MBIA Insurance Corporation
Armonk, New York 10504

Policy No. [NUMBER]

MBIA Insurance Corporation (the "Insurer"), in consideration of the payment of the premium and subject to the terms of this policy, hereby unconditionally and irrevocably guarantees to any owner, as hereinafter defined, of the following described obligations, the full and complete payment required to be made by or on behalf of the Issuer to [PAYING AGENT/TRUSTEE] or its successor (the "Paying Agent") of an amount equal to (i) the principal of (either at the stated maturity or by any advancement of maturity pursuant to a mandatory sinking fund payment) and interest on, the Obligations (as that term is defined below) as such payments shall become due but shall not be so paid (except that in the event of any acceleration of the due date of such principal by reason of mandatory or optional redemption or acceleration resulting from default or otherwise, other than any advancement of maturity pursuant to a mandatory sinking fund payment, the payments guaranteed hereby shall be made in such amounts and at such times as such payments of principal would have been due had there not been any such acceleration); and (ii) the reimbursement of a such payment which is subsequently recovered from any owner pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such owner within the meaning of any applicable bankruptcy law. The amounts referred to in clauses (i) and (ii) of the preceding sentence shall be referred to herein collectively as the "Insured Amounts." "Obligations" shall mean:

[PAR]
[LEGAL NAME OF ISSUE]

Upon receipt of telephonic or telegraphic notice, such notice subsequently confirmed in writing by registered or certified mail, or upon receipt of written notice by registered or certified mail, by the Insurer from the Paying Agent or any owner of an Obligation the payment of an Insured Amount for which is then due, that such required payment has not been made, the Insurer on the due date of such payment or within one business day after receipt of notice of such nonpayment, whichever is later, will make a deposit of funds, in an account with State Street Bank and Trust Company, N.A., in New York, New York, or its successor, sufficient for the payment of any such Insured Amounts which are then due. Upon presentment and surrender of such Obligations or presentment of such other proof of ownership of the Obligations, together with any appropriate instruments of assignment to evidence the assignment of the Insured Amounts due on the Obligations as are paid by the Insurer, and appropriate instruments to effect the appointment of the Insurer as agent for such owners of the Obligations in any legal proceeding related to payment of Insured Amounts on the Obligations, such instruments being in a form satisfactory to State Street Bank and Trust Company, N.A., State Street Bank and Trust Company, N.A. shall disburse to such owners, or the Paying Agent payment of the Insured Amounts due on such Obligations, less any amount held by the Paying Agent for the payment of such Insured Amounts and legally available therefor. This policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any Obligation.

As used herein, the term "owner" shall mean the registered owner of any Obligation as indicated in the books maintained by the Paying Agent, the Issuer, or any designee of the Issuer for such purpose. The term owner shall not include the Issuer or any party whose agreement with the Issuer constitutes the underlying security for the Obligations.

Any service of process on the Insurer may be made to the Insurer at its offices located at 113 King Street, Armonk, New York 10504 and such service of process shall be valid and binding.

This policy is non-cancellable for any reason. The premium on this policy is not refundable for any reason including the payment prior to maturity of the Obligations.

In the event the Insurer were to become insolvent, any claims arising under a policy of financial guaranty insurance are excluded from coverage by the California Insurance Guaranty Association, established pursuant to Article 14.2 (commencing with Section 1063) of Chapter 1 of Part 2 of Division 1 of the California Insurance Code.

IN WITNESS WHEREOF, the Insurer has caused this policy to be executed in facsimile on its behalf by its duly authorized officers, this [DAY] day of [MONTH, YEAR].

MBIA Insurance Corporation

____
President

Attest: ____________________________
Assistant Secretary

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